

# AeroMechanical Services – Third Quarter 2011



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## LETTER TO SHAREHOLDERS

During the third quarter of 2011, AeroMechanical Services Ltd. (“AMA” or the “Company”) made advancements in product development, attracting new contracts, regulatory testing and strengthening its financial position.

One of the most exciting accomplishments was our progress on the Automated Flight Information Reporting System (“AFIRS”™) 228 platform, taking it from a proof of concept to a fully marketable product. Most notably, our development team conducted DO-160F environmental testing during the third quarter. These tests were performed on production standard AFIRS 228 units manufactured by AMA to determine their performance characteristics in extreme environmental conditions similar to those that may be encountered in airborne operation such as temperature, altitude, humidity, vibration, and electromagnetic interference. We passed all tests.

Manufacturing facilities, processes and tests were set up in Calgary, Canada and witnessed by Transport Canada, to allow the Company to produce limited representative initial production (“LRIP”) units required to do the DO-160 tests. The Company purchased sufficient quantities of components to produce the AFIRS 228 units required for customer shipments in the fourth quarter of this year and those materials are reflected in inventories recorded in the third quarter.

Once the environmental test reports are approved by Transport Canada, we will be able to complete test flights on Hawker Beechcraft 750, Boeing 777 and Bombardier CRJ 900 aircraft, all slated to have AFIRS 228B units installed before the end of 2011. Overall, the initial AFIRS 228 project is nearly on schedule and within budget for completion by January 31, 2012. Development of AFIRS 228S hardware, which we anticipate will be safety services qualified in 2012, is proceeding as planned, although the timing for regulatory approval is outside of our control.

Sales and installations of AFIRS 220 continued in the third quarter, during which we signed three new contracts for a total of 14 units. New customers include a Middle Eastern airline, a U.S. charter carrier and a Nigerian airline, all operating Boeing aircraft fleets.

AFIRS received additional validation of its product strength during the third quarter due to a recommendation by the Bureau d’Enquêtes et d’Analyses (“BEA”). In an interim report on the loss of Air France Flight 447, the BEA recommended mandatory triggered data streaming technology on passenger aircraft flying over maritime and remote areas. The Company’s AFIRS products and its companion FLYHTStream™ meet these capabilities and are currently available to airlines. A BEA-sponsored meeting on this subject was held in Montreal on November 4, 2011, at which we were one of four presenters to the BEA and ICAO (the “International Civil Aviation Organization”). While airline regulations can take a long time to implement, our existing product and patent pending status on FLYHTStream position us well if this equipment becomes a mandated requirement for airlines.

Also during the third quarter, AMA received full payment for activation of a second operations command centre in Nigeria. The new facility was commissioned to improve aviation safety, both on land and in Nigeria’s extensive offshore oilfields. AMA hopes to continue to support and build its relationship with the Nigerian Civil Aviation Authority and the airlines in that country.

Revenue during the third quarter increased by almost 43% over the same quarter of 2010 to \$1.4 million. The majority of the increase was generated from payment for the operations centre in Nigeria.

The Company, aided by a tax credit and government funding, reduced research and development (“R&D”) expenses in this quarter by \$627,115. The scientific research and experimental development (“SRED”) tax credit contributed to the R&D reduction by approximately \$356,000. The Company also received approximately \$223,000 for the first payment for efforts under the strategic aerospace defense initiative (“SADI”) repayable investment program announced in February 2011.

The combination of increased product sales, tight cost controls and program funding allowed the Company to increase its cash position to \$3.5 million at September 30, 2011 from \$3.3 million at June 30, 2011.

Subsequent to the third quarter, an AMA delegation attended the National Business Aviation Association's annual convention in early October. Also in attendance was a delegation from our partner in China, SKYBLUE Technologies Company, the exclusive reseller of AFIRS Iridium-based data and voice services to the Chinese aviation community.

The two companies participated in strategic meetings with a number of original equipment manufacturers ("OEMs") attending the show. The meetings were arranged to discuss the regulations initiated by the General Administration of Civil Aviation of China in September 2011, which will require the installation of long distance communications systems for all business aircraft operating in China in the near future. The OEMs were interested in our delegation as major growth in business aviation is predicted in China over the next several years. China's recent investment in airport infrastructure, new air traffic control regulations and increased emphasis on training of pilots and operations personnel have combined to attract interest of the international aviation community. The new regulations also apply to commercial aircraft and we are prepared to support this part of the market as well.

Looking ahead to the fourth quarter, AMA expects to complete a number of objectives in product development, marketing and sales. Most importantly, we have a team of skilled people delivering our products on time and on budget. We conserved cash this quarter through careful management of costs, including keeping R&D under control, and will strive to make the upcoming quarters successful for both the shareholders and employees of AMA.

As always, we thank our shareholders for their support, our staff for their unrelenting efforts and our customers for their loyalty and continued support.



Bill Tempany  
Chairman and Chief Executive Officer

## MANAGEMENT DISCUSSION & ANALYSIS

This management discussion and analysis (“MD&A”) is as of November 9, 2011 and should be read in conjunction with the unaudited interim condensed consolidated financial statements of AeroMechanical Services Ltd. (“AMA” or the “Company”) for the three and nine months ended September 30, 2011 and the accompanying notes. Additional information with respect to AMA can be found on SEDAR at [www.sedar.com](http://www.sedar.com) which is supplemental to the unaudited interim condensed consolidated financial statements and notes for the three and nine month periods ended September 30, 2011. The Company has prepared its September 30, 2011 Condensed Consolidated Interim Financial Statements in accordance with IFRS1, First-Time Adoption of International Financial Reporting Standards (“IFRS” or “GAAP”), and with IAS 34, Interim Financial Reporting, as issued by the International Accounting Standards Board (“IASB”). Previously, the Company prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles (“Canadian GAAP”). The adoption of IFRS has not had a material impact on the Company’s operations, strategic decisions, cash flow and capital expenditures. The Company’s IFRS accounting policies are provided in Note 3 to the Interim Condensed Consolidated Financial Statements. In addition, Note 15 to the Interim Condensed Consolidated Financial Statements presents reconciliations between the Company’s 2010 Canadian GAAP and the 2010 IFRS results. The reconciliations include the Reconciliation of Equity as at September 30, 2010, and the Reconciliation of Comprehensive Income (Loss) for the three and nine month periods ended September 30, 2010.

### Non-GAAP Financial Measures

The Company reports its financial results in accordance with 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 revenues 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. 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 AMA'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 the Company's 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 its customers and to ensure that the communications between terrestrial and airborne staff and assets are to the highest possible standard. AMA's tools also provide the ability to deliver large amounts of data, on demand and initiated automatically, if specific parameters are breached and detected on the aircraft, by manual selection, by the air crew or commenced by authorized ground personnel, through the Company's patent pending FLYHTStream™ product.

### *AFIRS™ 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 relays 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 developed and has patent pending technology to stream aircraft data in real time. If an aircraft 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 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 designed this unique application that highlights exceptions to best practices, provides quick drill downs to spot root cause, and identifies trends. It is an intuitive tool that enables fuel managers to act on information instead of compiling and analyzing data.

## *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 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, associated costs are shown. The tool is de-identified to meet pilot union requirements, but can be filtered to display performance by pilot if desired.

## *Underfloor Stowage Unit*

The Underfloor Stowage Unit offers the flight crew additional stowage space in the cockpit. With this addition, manuals will always be within reach of the seated crew. When in use, 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 Bombardier CRJ series, Challenger and DHC-8’s and can also be installed in other aircraft types.

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

## **Trends and Economic Factors**

AMA continues to capitalize on the need for timely flight and sensor data from aircraft to ground operations and maintenance facilities.

During the third quarter, the Company witnessed a guarded optimism across the aviation industry. This resulted in a higher level of interest in AMA’s solutions than in previous quarters but airlines continue to be slow to commit to capital projects. While the aviation industry has seen an increase in air travel, both business and vacation, it remains far from pre-recession levels. The modest increase in capital expenditures across the international aviation industry has resulted in customer payment or shipment for eight AFIRS kits in the third quarter. At the end of the third quarter AMA had a backlog of 117 pending shipments or units not yet activated, excluding units contracted by its Chinese customer. During the third quarter the Company continued to negotiate with potential customers, which resulted in signing an AFIRS 228 contract for three aircraft announced July 11, 2011. AFIRS 220 contracts from the quarter include an operator in the Middle East announced August 17, 2011, an international charter airline based in the United States announced September 13, 2011 and a Nigerian airline announced September 14, 2011. Early in the fourth quarter, a current customer signed an agreement for AFIRS 228. As well, as announced on August 15, 2011, the Company received payment for a second operations centre in Nigeria. Negotiations continue with potential customers for both the AFIRS 220 and the AFIRS 228.

In addition, the Company continues to meet the needs of the aviation industry through the introduction of value-added information products and specialty services that can build customer value and AMA revenues from existing installations as well as new ones. Three areas of concentration continue to be the essential flight data recorder streaming, the fuel management program and related product enhancements, and fee-for-service consulting services. The Company views these initiatives as enhancements to the industry and as providing strong potential to strengthen the monthly recurring revenues.

The slight weakening of the Canadian dollar relative to the U.S. dollar during the third quarter of 2011 had a positive impact on the Company’s revenue and income. As a result of these movements, the Company’s Canadian dollar revenues, which are substantially all denominated in U.S. dollars, were higher than they would have been had the foreign exchange rates not changed. While an amount of the Company’s costs are denominated in Canadian dollars, a significant portion of marketing and component costs are U.S. dollar denominated, and therefore create a natural hedge against fluctuations of the Canadian dollar.

# RESULTS OF OPERATIONS – THREE MONTHS ENDED SEPTEMBER 30, 2011

## Revenue

The Summary of Quarterly Results Table (page 13) outlines the quarterly installation kits, recurring voice and data, miscellaneous parts and technical services. The Company's long term investment in marketing and relationship building has created a strong pipeline of prospective clients around the world. The ongoing revenue streams from AMA's existing client base is expected to continue to expand throughout this and future years. Installation delays associated with customers' decisions to install AFIRS during heavy maintenance continue to delay revenue recognition, but they represent captive long-term recurring revenue.

The Company has two types of revenue streams relating to AFIRS equipment depending on the type of service agreement: rental and sales. 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, UpTime usage fees are recognized as the service is provided based on actual customer usage each month. The amounts recorded in unearned revenue are non-refundable.

AMA received \$1,713,301 in cash revenues in the quarter with \$1,440,195 reported as revenue and \$273,106 included in unearned revenue. That compares to \$1,333,889 in cash revenue in the third quarter of 2010 with \$1,009,967 reported as revenue and \$323,922 in unearned revenue.

Revenue increased by \$430,228 in the third quarter compared to the third quarter of last year. Installation kit revenues increased by \$143,416 as the result of increased recognition of unearned revenue. Recurring voice and data revenue increased by \$60,392 due to increased phone and data usage in combination with the weaker Canadian dollar, which offset a decrease of 6,130 flight hours from the same quarter of 2010. Parts revenue decreased by \$37,882 from the third quarter of 2010. Technical services revenue increased by \$264,302 due to the completion of a second operations centre for a state owned and operated Nigerian airport. The increase in technical services revenue was partially offset by a reduction in installation support for existing customers.

## Gross Profit

AMA's cost of product sales includes the direct cost of the AFIRS kit, installation and training support as well as associated shipping expenses and travel expenses for the Company's engineering personnel's onsite installation support. Installations on aircraft are performed by third parties at the customer's expense. Cost of sales as a percentage of revenue in the third quarter of 2011 was 37.3% compared to 49.6% in the same quarter of 2010. This decrease was due to the mix of revenue sources and the Company's ability to keep cost of sales relatively constant in relation to revenue.

Gross margin as a percent of revenue for the past eight quarters was 62.7% for Q3 2011 compared to 59.8% for Q2 2011, 56.0% for Q1 2011, 66.7% for Q4 2010, 50.4% for Q3 2010, 55.9% for Q2 2010, 56.5% for Q1 2010, and 64.6% for Q4 2009, (note that data for the quarters before January 1, 2010 has not been restated for the adoption of IFRS and therefore the ability to use for comparison purposes may be limited).

## Operating Activities

### *Other Income*

Other income consists of the recognition of the Sierra Nevada Corporation ("SNC") license fee that was deferred as unearned revenue when received and is being recognized over the initial five year term of the agreement.

### *Distribution Expenses*

Distribution costs, which consists of overhead expenses associated with the delivery of services to customers and sales and marketing increased by \$56,991 from the third quarter of 2010. Salaries and benefits decreased by \$113,915, mainly due to increased involvement of operations staff in R&D activities associated with the AFIRS 228 project and the resulting allocation of their salary costs to R&D. Contract labour increased by \$45,962 as the result of the addition of a marketing consultant who is developing collateral sales material and programmers who are focused on existing product functionality. Office expenses increased by \$17,957 due to an allocation between cost centers and not due to an increase in the overall expense. The \$88,377 increase in travel expenses in the third quarter of 2011 versus the same quarter last year was largely the result of increased travel and meals associated with marketing activities including trade show attendance. Expenses related to equipment and equipment maintenance increased by \$2,031, due to costs associated with the movement of the UpTime hosting centre earlier in the year to accommodate growth in the installation base. Marketing increased by \$16,447 due to the creation of marketing materials to deal with new functionality related to the AFIRS 228.

### *Administration Expenses*

Administration costs consist of overhead expenses associated with the general operations of the Company that are not directly associated with delivery of services or sales. These expenses decreased by \$163,721 from the third quarter of 2010. There were several contributors, one of which was a \$22,852 reduction in legal fees due to an overall reduction in legal services and specifically the legal proceedings by a Toronto based company. Contract labour decreased by \$17,957 due to a reduction in consulting related to the conversion to IFRS which occurred in 2010 plus a general reduction in the requirement for contract labour related to administrative activities. Travel expenses increased by \$7,505 from the third quarter of 2010 due to general travel requirements in the third quarter of 2011 that were not required in the same period last year. Depreciation expense also decreased from the third quarter of 2010 by \$24,609 due to a number of capital assets that have been fully depreciated over the past year. Moving forward, a portion of this equipment will require replacement and depreciation expense is expected to increase. Investor relations ("IR") expenses increased by \$14,810 due to costs associated with the engagement of an IR firm in addition to the existing supplier and the increased use of multimedia services for investor relations communications. Salaries and benefits decreased by \$36,499 from the third quarter of 2010 due to the allocation of labour costs to projects and R&D. This allocation did not reduce overall salary expense. Audit expenses decreased by \$52,547 over the third quarter of 2010 due to a combination of reduced audit fees and reduced costs associated with conversion to IFRS. Office expenses decreased \$36,378 due primarily due to the allocation of office space rental to cost centres and not to an overall reduction in rental costs. Insurance costs decreased due to negotiated reductions in premiums, and there were decreases in staff training costs, telephone expenses, subscriptions expenses and postage and courier expenses which were partially offset by an increase in stationery and supplies expense.

### *Research and Development Expenses*

Research and development costs for the third quarter of 2011 totaled \$1,118,167 as compared to \$1,745,282 for the same period in 2010, a decrease of \$627,115. The decrease resulted from several factors, one of which was the recognition of \$142,367 in reimbursement of expenses under the Strategic Aerospace Defense Initiative ("SADI") government grant program. In addition, there was a decrease in contract labour of \$916,307 and travel of \$6,346 which were partially offset by an increase in salaries and benefits of \$226,912. These changes stemmed from the decision to repatriate the core software development to Calgary and build a team around the existing resources of AMA's Calgary based contractors and staff. This decision has more than met expectations, both in deliverables and cost reduction as evidenced by the successful flight test on a potential customer's Hawker Beechcraft aircraft on May 16, 2011 and the receipt of a provision only STC for AFIRS 228 installation on the Boeing 777 as announced on July

18, 2011. R&D costs were reduced during Q3 2011 while meeting and/or exceeding all development timelines. These decreases were partially offset by increased expenses related to the purchase and maintenance of equipment of \$123,115 as well as components of \$85,564 which were required to manufacture AFIRS 228 test units.

As announced in the first quarter of 2011, the Company signed an agreement with the Canadian government under the SADI program whereby the Company will receive a repayable contribution of 30% of eligible AFIRS 228 development costs to a maximum of \$1.96 million. The contribution will be repayable over 15 years commencing April 30, 2014. In the third quarter, payment of \$223,033 was received for the claim submitted in the second quarter which was accounted for as a grant of \$142,367 and a loan payable of \$80,666 per International Accounting Standard 20.

### *Net Finance Costs*

Net finance costs consist of interest revenue, realized and unrealized foreign exchange gains and losses, bank service charges, interest expense, accretion of debenture interest, and amortization of the debenture issue costs. Finance income increased over the third quarter of 2010 by \$16,940 due to increased net foreign exchange gain. Finance costs increased by \$116,407 due primarily to debenture interest expense and the amortization of debenture issue costs which totaled \$116,955.

### *Net Loss*

The net loss in the quarter ending September 30, 2011 was \$1,576,944 compared to a loss of \$2,601,005 in the same quarter of 2010, which is a decrease of \$1,024,061. This decrease is primarily due to increased gross profit of \$393,994 coupled with increased distribution expenses of \$56,991, decreased administrative expenses of \$163,721, decreased R&D of \$627,115 and increased finance income of \$16,940 which was offset by increased finance costs of \$116,407. If the loss in the third quarter 2011 was adjusted by removing R&D, including the extensive development of the next generation AFIRS 228, the loss would have been \$458,777 compared to \$855,723 or a decrease of \$396,946 compared to the adjusted loss in the third quarter of 2010.

# RESULTS OF OPERATIONS – NINE MONTHS ENDED SEPTEMBER 30, 2011

## Revenue

AMA received \$4,514,475 in cash revenues in the first nine months of 2011 with \$3,862,558 reported as revenue and \$651,917 included in unearned revenue. That compares to \$4,308,005 in cash revenue in the same period of 2010 with \$3,264,077 reported as revenue and income and \$1,043,928 in unearned revenue.

Revenue increased by \$598,481 in the period compared to the same period last year. Installation kit revenues increased by \$19,546 from 2010 as the result of increased recognition of unearned revenue. Recurring voice and data revenue increased by \$121,661 due to increased phone and data usage in combination with the weaker Canadian dollar which offset a decrease of 6,810 flight hours during the nine-month period. The reduction in flight hours resulted from lower utilization of aircraft by some operators. Parts revenue increased by \$27,116 owing to increased sales of Underfloor Stowage Units when compared to the first three quarters of 2010 and the sale of spare Wingspeed parts to a customer. Technical Services revenue increased by \$430,158 over the first three quarters of 2010 due to the installation of additional capability and equipment at AMA's first command and control centre in Nigeria, the installation of an operations centre for a state owned and operated Nigerian airport and installation support for an existing customer.

## Operating Activities

### *Distribution Expenses*

Distribution costs decreased by \$326,617 from the first three quarters of 2010. Salaries and benefits decreased by \$386,143 mainly due to increased involvement of operations staff in R&D activities associated with the AFIRS 228 project and the allocation of their salary costs to R&D. Contract labour increased by \$115,498 as a result of the addition of a marketing consultant who is developing collateral sales material and programmers who are focused on existing product functionality. Other expenses decreased by \$143,393 from the first three quarters of 2010 due to bad debt expense in the first three quarters of 2010 related to the bankruptcy of a customer. No such unfortunate incidents occurred in the first three quarters of 2011. The \$25,769 increase in travel expenses in the first three quarters of 2011 resulted from higher expenses this year for travel and meals related to increased sales activities and trade show attendance. Marketing expenses increased by \$15,741 compared to the third quarter of 2010 due to the development of an updated website and marketing materials. Office expenses increased by \$14,121 primarily due to an increase in rent expense of \$11,135 resulting from the allocation to cost centres which did result in an overall expense reduction. The remaining increase was the result of minor changes in office expenses such as training, stationery, subscriptions, telephones, and postage and courier expenses. Expenses related to equipment and equipment maintenance increased by \$31,790 in the first three quarters of 2011 versus the same period of 2010. The increase was due to costs associated with the movement of the UpTime hosting centre and the required equipment and software maintenance related to the move.

### *Administration Expenses*

Administration costs decreased by \$428,360 from the first three quarters of 2010. The major differences were lower legal fees of \$109,967 due to a general reduction in legal services and specifically to legal proceedings by a Toronto based company. Contract labour costs decreased by \$53,586 during the same period due to the combination of a decrease in consulting related to the conversion to IFRS of \$51,969, an increase of \$40,060 for the ongoing work with an organizational effectiveness consultant, a decrease in fees related to the recruitment of staff of \$37,040 and a general reduction in the requirement for contract labour and consultants of \$4,637. Travel expenses decreased by \$72,690 from the first three quarters of 2010 due to a reduction in IR and general travel resulting from the work in early 2011 to realign and focus initiatives in the IR domain. As the revised IR plan is rolled out it is expected that these costs will return to or exceed the levels of previous quarters. Depreciation expense also decreased from the first three quarters of 2010 by \$51,971 due to a number of capital assets that have been fully depreciated over the past year. Moving forward a portion of this equipment will require replacement, and depreciation expense is expected to

increase as a result. IR expenses increased by \$34,641 due to costs associated with the engagement of an IR firm in addition to the existing supplier and hosting a retail luncheon for investors in June. Salaries and benefits decreased by \$91,015 from the first three quarters of 2010 due to the allocation of labour costs to projects and R&D. This allocation did not reduce overall salary expense. Office expenses for the first three quarters of 2011 decreased by \$26,051 which is the result of rent expense decrease of \$16,061 resulting from the allocation to cost centres which did not result in an overall expense reduction. As well, insurance premiums decreased for the first three quarters of 2011 of \$12,791, and there were minor changes in other office related expenses. Audit and accounting expenses decreased by \$60,906, due to a reduction in accrued audit fees recognized in 2011 versus 2010 of \$38,244, decrease in IFRS conversion consulting of \$2,640, and reversal of audit fee accrual for 2010 versus actual of \$21,515.

### *Research and Development Expenses*

R&D costs for the first three quarters of 2011 were \$2,456,269 as compared to \$4,219,938 in 2010, a decrease of \$1,763,669. The decrease was the result of the recognition of the provincial Scientific Research and Experimental Development ("SRED") tax credit of \$355,982 and the reimbursement of expenses under the federal SADI grant program. In the third quarter, payment of \$223,033 was received for the claim submitted in the second quarter which was accounted for as a grant of \$142,367 and a loan payable of \$80,666 per International Accounting Standard 20. The remaining decrease resulted from the decision early in the first quarter of 2011 to repatriate the core software development to Calgary and build a team around the existing resources of AMA's Calgary based contractors and staff. This decision has more than met expectations, both in deliverables and cost reduction as evidenced by the receipt of a provision only STC for the Hawker Beechcraft Series 987 aircraft as announced on March 9, 2011 and for the Boeing 777 as announced on July 18, 2011. In addition, the AFIRS 228 had a successful flight test on a potential customer's Hawker Beechcraft aircraft on May 16, 2011. R&D costs were reduced during the first three quarters of 2011 while meeting and/or exceeding all development timelines. Specifically contract labour, travel and office expenses decreased \$1,571,914, \$86,850 and \$13,393 respectively which were offset by an increase in salaries and benefits of \$318,969. As well, equipment and maintenance increased \$122,162 due to the need to acquire equipment to complete the AFIRS 228 and components increased \$21,137 as the result of the production of initial AFIRS 228 test units.

### *Net Finance Costs*

Finance income increased by \$48,375 due to increased interest revenue from deposits of \$7,972 and increased foreign exchange gain of \$40,403 in the first three quarters of 2011. Finance costs increased by \$330,177 to \$359,754 due primarily to debenture interest expense and the amortization of debenture issue costs. The increase was partially offset by a reduction of \$1,934 in bank charges and lower interest expense of \$5,391.

### *Net Loss*

The year to date net loss as at September 30, 2011 was \$4,459,677 compared to a loss of \$7,224,249 in the first three quarters of 2010, a decrease of \$2,764,572. The decrease was primarily due to increased gross profit of \$533,569 coupled with decreased distribution expenses of \$326,617, reduced administrative expenses of \$428,360, decreased R&D expenses of \$1,763,669, higher finance income of \$48,375 off-set by increased finance costs of \$330,177 and increased income tax expense of \$1,530. If the loss in the first three quarters of 2011 was adjusted by removing R&D, including the extensive development of the next generation AFIRS 228, the loss would have been \$2,003,408 compared to \$3,004,311 or a decrease of \$1,000,903 compared to the adjusted loss for the first three quarters of 2010.

## Summary of Quarterly Results

	Q4-09	Q1-10	Q2-10	Q3-10	Q4-10	Q1-11	Q2-11	Q3-11
<b>Revenue &amp; Income (Cash)</b>	\$ 725,565	\$ 1,267,676	\$ 1,706,440	\$ 1,333,889	\$ 1,573,837	\$ 1,373,781	\$ 1,427,393	\$ 1,713,301
<b>Revenue &amp; Income (GAAP)</b>	1,006,664	1,041,883	1,212,228	1,009,967	1,421,044	1,121,452	1,300,911	1,440,195
<b>Loss</b>	1,189,445	2,063,614	2,559,634	2,601,005	1,911,047	1,485,292	1,397,442	1,576,944
<b>Loss before R&amp;D</b>	1,103,034	1,026,209	1,122,377	855,723	350,174	702,805	841,827	458,777
<b>Loss/Share</b>	\$ 0.01	\$ 0.02	\$ 0.02	\$ 0.03	\$ 0.02	\$ 0.01	\$ 0.02	\$ 0.01

The information for the quarter Q4-09 was prepared prior to the application of IFRS and was not restated. For this reason the value of the information for comparative purposes may be limited.

## Liquidity and Capital Resource

As of September 30, 2011 the Company had negative working capital of \$370,866 compared to negative working capital of \$907,261 in the same period of 2010, an increase of \$536,395. The increase in working capital is attributed primarily to increased cash of \$1,779,944, increased accounts receivable of \$206,788, increased prepaid expenses and deposits of \$42,423, decreased inventory of \$258,073, increased accounts payable of \$1,707,251, a decrease in the current portion of unearned revenue of \$379,629, a decrease in the current portion of loans and borrowings of \$68,251, and a decrease in the current portion of obligation under capital leases of \$24,684.

Neither customer deposits nor the current portion of unearned revenue are refundable and if those two items are not included in the working capital calculation, the resulting modified working capital at September 30, 2011 would be \$2,489,245 compared to \$1,702,682 in 2010. As well, at September 30, 2011 the Company had outstanding accounts payable to SNC of \$1,855,196 relating to their involvement with the development of the AFIRS 228. As reported in the 2010 Annual Report the development effort for the AFIRS 228 program was split into four general modules: (1) hardware, (2) board support software (both developed by a Calgary contractor), (3) Embedded Logic Applications ("ELA") (developed by AMA staff in Calgary), and (4) core software (the responsibility of SNC). Late in 2010, it was recognized by management that progress on the AFIRS 228 program was on track for year end delivery for the hardware, board support software and ELA. However, time estimates to complete the core software continued to slip and costs had escalated. In the first quarter of 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 AMA's 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 that meets the timelines required by our current customers and prospects. The current accounts payable amount of \$1,855,196 as at September 30, 2011 is being reviewed by both parties and negotiations are ongoing to reduce this liability while maintaining the relationship with the manufacturing and military market.

The Company's net cash decrease for the first three quarters of 2011 was \$3,295,003 compared to \$5,445,581 for the same period of 2010. Also, it is important to note that the net cash increased \$245,717 from the end of the second quarter of 2011 as the result of various factors including the receipt of SRED and SADI funds during the quarter, tight control over accounts receivables collections, the decision earlier in 2011 regarding the AFIRS 228 development and the resulting decrease in costs, increased shipments and delivery of technical services to customers and an overall reduction in expenses.

The Company has an available operating line of \$250,000 that was undrawn at September 30, 2011. 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 ongoing operations. If general economic conditions or the financial condition of a major customer deteriorates then 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 November 9, 2011, AMA's issued and outstanding share capital was 118,630,466.

## 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 has been included in the consolidated interim 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 their interference with legally binding contracts, disrupted business, attacks on the Company's reputation and costs. During the third quarter of 2011 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.

## Contractual Obligations

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

Year	Premises	Equipment	Total
2011	\$ 108,706	\$ 23,455	\$ 132,161
2012	445,685	45,020	490,705
2013	458,718	12,700	471,418
2014	76,815	5,292	82,107
2015	-	-	-
<b>Total</b>	<b>\$ 1,089,924</b>	<b>\$ 86,467</b>	<b>\$ 1,176,391</b>

## Recent Accounting Pronouncements

All accounting standards effective for periods beginning on or after January 1, 2011 have been adopted as part of the transition to IFRS. The following new accounting pronouncements have been issued but are not effective and may have an impact on the Company:

As of January 1, 2013, the Company will be required to adopt IFRS 9, Financial Instruments, which is the result of the first phase of the International Accounting Standards Board's ("IASB") project to replace IAS 39, Financial Instruments: Recognition and Measurement. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. It is anticipated that the adoption of this standard will not likely have a material impact on the Company's financial statements.

All of the following new or revised standards permit early adoption with transitional arrangements depending upon the date of initial application:

IFRS 9 – Financial Instruments addresses the classification and measurement of financial assets.

IFRS10 – Consolidated Financial Statements builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within consolidated financial statements of the parent company.

IFRS11 – Joint Arrangements establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

IFRS 12 – Disclosure of Interest in Other Entities provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.

IFRS 13 – Fair Value Measurement defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

IFRS 27 – Separate Financial Statements revised the existing standard which addresses the presentation of parent company financial statements that are not consolidated financial statements.

IFRS 28 Investments in Associate and Joint Ventures revised the existing standard and prescribes the accounting for investments and sets out requirements for application of the equity method when accounting for investments in associates and joint ventures.

The Company has not completed its evaluation of the effect of adopting these standards on its consolidated financial statements.

## Auditors' Involvement

National Instrument 51-102, Part 4, subsection 4.3 (3) (a), requires that if an auditor has not performed a review of the interim financial statements there must be an accompanying notice to the interim statements indicating that the interim financial statements have not been reviewed by an auditor.

The auditors of AeroMechanical Services Ltd. have not performed a review of the unaudited condensed consolidated interim financial statements for the three and nine month periods ended September 30, 2011 and September 30, 2010.

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (unaudited)

	September 30, 2011	December 31, 2010
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 3,491,272	\$ 6,617,852
Restricted cash	250,000	250,000
Trade and other receivables	764,256	882,895
Deposits and prepaid expenses	171,763	140,304
Inventory	1,234,921	1,456,132
<b>Total current assets</b>	<b>5,912,212</b>	<b>9,347,183</b>
<b>Non-current assets</b>		
Property and equipment	352,805	402,535
Rental assets	126,764	155,101
Intangible assets	235,865	339,810
Inventory	864,967	779,052
<b>Total non-current assets</b>	<b>1,580,401</b>	<b>1,676,498</b>
<b>Total assets</b>	<b>\$ 7,492,613</b>	<b>\$ 11,023,681</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Trade payables and accrued liabilities	\$ 4,523,235	\$ 3,508,175
Unearned revenue (note 4)	1,607,621	2,105,409
Loans and borrowings (note 5)	84,191	86,557
Finance lease obligations	68,031	86,118
<b>Total current liabilities</b>	<b>6,283,078</b>	<b>5,786,259</b>
<b>Non-current liabilities</b>		
Unearned revenue (note 4)	559,104	726,469
Loans and borrowings (note 5)	2,757,425	2,381,972
Finance lease obligations	49,658	68,956
Provisions	57,093	61,239
<b>Total non-current liabilities</b>	<b>3,423,280</b>	<b>3,238,636</b>
<b>Total liabilities</b>	<b>9,706,358</b>	<b>9,024,895</b>
<b>Equity (deficit)</b>		
Share capital (note 6)	36,741,492	36,730,844
Convertible debenture	389,110	389,110
Warrants (note 6)	2,894,018	5,134,018
Contributed surplus (note 6)	6,226,612	3,750,114
Accumulated other comprehensive income (loss)	-	-
Deficit	(48,464,977)	(44,005,300)
<b>Total equity (deficit)</b>	<b>(2,213,745)</b>	<b>1,998,786</b>
<b>Total liabilities and equity (deficit)</b>	<b>\$ 7,492,613</b>	<b>\$ 11,023,681</b>

See accompanying notes to condensed consolidated interim financial statements

Contingencies (note 13)

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS) (unaudited)

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010 (Note 15)	2011	2010 (Note 15)
Revenue	\$ 1,440,195	\$ 1,009,967	\$ 3,862,558	\$ 3,264,077
Cost of sales	537,667	501,433	1,553,822	1,488,910
<b>Gross profit</b>	902,528	508,534	2,308,736	1,775,167
Other income	64,380	68,691	193,140	197,451
Distribution expenses (note 8)	814,857	757,866	2,422,266	2,748,883
Administration expenses (note 9)	507,254	670,975	1,794,852	2,223,212
Research and development expenses (note 10)	1,118,167	1,745,282	2,456,269	4,219,938
<b>Results from operating activities</b>	(1,473,370)	(2,596,898)	(4,171,511)	(7,219,415)
Finance income (note 11)	22,743	5,803	77,469	29,094
Finance costs (note 11)	126,317	9,910	359,754	29,577
<b>Net finance costs</b>	(103,574)	(4,107)	(282,285)	(483)
<b>Loss for the period before income tax</b>	(1,576,944)	(2,601,005)	(4,453,796)	(7,219,898)
Income tax expense	-	-	5,881	4,351
<b>Loss for the period</b>	(1,576,944)	(2,601,005)	(4,459,677)	(7,224,249)
Foreign currency translation	6	1,051	-	1,024
<b>Total comprehensive loss for the period</b>	\$ (1,576,938)	\$ (2,599,954)	\$ (4,459,677)	\$ (7,223,225)
<b>Earnings (loss) per share</b>				
Basic and diluted earnings (loss) per share (note 12)	\$ (0.01)	\$ (0.03)	\$ (0.04)	\$ (0.07)

See accompanying notes to condensed consolidated interim financial statements

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (DEFICIT)

For nine months ended September 30 (unaudited)

	Share Capital	Convertible Debenture	Warrants	Contributed Surplus	Foreign Currency Translation Reserve*	Deficit	Total Equity (Deficit)
<b>Balance at January 1, 2010</b>	\$ 35,550,028	\$ -	\$ 4,181,685	\$ 1,956,075	\$ -	\$ (34,870,004)	\$ 6,817,784
Loss for the period	-	-	-	-	-	(7,224,249)	(7,224,249)
Foreign currency translation differences	-	-	-	-	1,024	-	1,024
<b>Total comprehensive loss for the period</b>	-	-	-	-	1,024	(7,224,249)	(7,223,225)
<b>Contributions by and distributions to owners</b>							
Share-based payment transactions	-	-	-	257,096	-	-	257,096
Share options exercised	47,650	-	-	(18,300)	-	-	29,350
Warrants expired	-	-	(1,452,371)	1,452,371	-	-	-
Total contributions by and distributions to owners	47,650	-	(1,452,371)	1,691,167	-	-	286,446
<b>Balance, September 30, 2010</b>	\$ 35,597,678	\$ -	\$ 2,729,314	\$ 3,647,242	\$ 1,024	\$ (42,094,253)	\$ (118,995)
<b>Balance at January 1, 2011</b>	\$ 36,730,844	\$ 389,110	\$ 5,134,018	\$ 3,750,114	\$ -	\$ (44,005,300)	\$ 1,998,786
Loss for the period	-	-	-	-	-	(4,459,677)	(4,459,677)
Foreign currency translation differences	-	-	-	-	-	-	-
<b>Total comprehensive loss for the period</b>	-	-	-	-	-	(4,459,677)	(4,459,677)
<b>Contributions by and distributions to owners</b>							
Share issue cost recovery	3,913	-	-	-	-	-	3,913
Share-based payment transactions	-	-	-	239,183	-	-	239,183
Share options exercised	6,735	-	-	(2,685)	-	-	4,050
Warrants expired	-	-	(2,240,000)	2,240,000	-	-	-
Total contributions by and distributions to owners	10,648	-	\$ (2,240,000)	2,476,498	-	-	247,146
<b>Balance, September 30, 2011</b>	\$ 36,741,492	\$ 389,110	\$ 2,894,018	\$ 6,226,612	\$ -	\$ (48,464,977)	\$ (2,213,745)

\*Accumulated other comprehensive income (loss)

See accompanying notes to condensed consolidated interim financial statements

# CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

## (unaudited)

	For the nine months ended September 30	
	2011	2010 (Note 15)
<b>Cash flows from operating activities</b>		
Loss for the period	\$ (4,459,677)	\$ (7,224,249)
Adjustments for:		
Depreciation	104,368	156,339
Depreciation of rental assets	33,493	26,831
Amortization of intangible assets	103,945	103,945
Convertible debenture accretion	278,791	-
Government grant accretion	124	-
Government grant (note 10)	(142,367)	-
Amortization of debenture issue costs	58,587	-
Equity-settled share-based payment transactions	239,183	257,096
Change in inventories	135,296	122,711
Change in intangible assets	-	(568)
Change in trade and other receivable	82,826	(14,360)
Change in prepayments	(31,459)	164,041
Change in trade and other payables	945,465	1,553,808
Change in provisions	(4,146)	10,881
Change in unearned revenue	(665,153)	(328,389)
Unrealized foreign exchange	(63,015)	(21,972)
Interest income	(22,392)	(14,420)
Interest expense	6,264	11,655
<b>Net cash used in operating activities</b>	<b>(3,399,867)</b>	<b>(5,196,651)</b>
<b>Cash flows from investing activities</b>		
Acquisitions of property and equipment	(54,638)	(133,431)
Acquisitions of rental assets	(5,156)	(45,056)
Interest received	22,392	14,420
<b>Net cash used in investing activities</b>	<b>(37,402)</b>	<b>(164,067)</b>
<b>Cash flows from financing activities</b>		
Share issue cost recovery	3,913	-
Proceeds from exercise of share options and warrants	4,050	29,350
Proceeds from government grant	223,033	-
Repayment of loans and borrowings	(45,081)	(56,860)
Payment of finance lease liabilities	(37,385)	(45,698)
Interest paid	(6,264)	(11,655)
<b>Net cash used in financing activities</b>	<b>142,266</b>	<b>(84,863)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(3,295,003)</b>	<b>(5,445,581)</b>
Cash and cash equivalents at January 1	6,617,852	7,161,427
Effect of exchange rate fluctuations on cash held	168,423	(4,518)
<b>Cash and cash equivalents</b>	<b>\$ 3,491,272</b>	<b>\$ 1,711,328</b>

# NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (unaudited)

## 1. Reporting entity

AeroMechanical Services Ltd. (the “Company” or “AMA”) was founded in 1998. The Company has been listed on the TSX Venture (TSX.V: AMA) since March 2003 and is a public company incorporated under the Canada Business Corporations Act and is domiciled in Canada. The address of the Company’s head office is 200W, 1144 – 29<sup>th</sup> Avenue NE, Calgary, Alberta T2E 7P1.

The condensed consolidated interim financial statements of the Company as at and for the three and nine months ended September 30, 2011 and 2010 comprise the Company and its subsidiaries.

AMA is a designer, developer, and service provider to the global aerospace industry. The Company supports aviation customers in different sectors including commercial, business, leasing and military operators. Clients are using AMA's products on every continent and the Company proudly serves more than 30 aircraft operators globally. AMA's headquarters are located in Calgary, Canada with representation in China, the Middle East, South America, the United States and Europe. The Company's solutions and services are sold under the FLYHT brand name.

The consolidated financial statements of the Company as at and for the year ended December 31, 2010 which were prepared under Canadian GAAP are available upon request from the Company’s registered office or at [www.flyht.com](http://www.flyht.com).

## 2. Basis of preparation

### *(a) Statement of compliance*

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. These are the Company’s third International Financial Reporting Standards (“IFRS”) condensed consolidated interim financial statements for part of the period covered by the first IFRS annual financial statements and IFRS 1 First-time Adoption of IFRS has been applied. The condensed consolidated interim financial statements do not include all of the information required for full annual financial statements.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of AMA is provided in Note 15. This note includes reconciliations of equity and total comprehensive income for comparative periods reported under previous Canadian GAAP to those reported for those periods under IFRS.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and effective as of November 9, 2011. Any subsequent changes to IFRS that become effective and are adopted for the December 31, 2011 annual financial statements could result in revisions to accounting policies applied in these condensed consolidated interim financial statements, and if applicable, the reconciliations included herein and the opening statement of financial changes.

The condensed consolidated interim financial statements were authorized for issue by the Board of Directors on November 9, 2011.

### *(b) Basis of measurement*

The condensed consolidated interim financial statements have been prepared on an historical cost basis except for financial instruments at fair value through profit or loss, which are measured at fair value in the statement of financial position (“SFP”).

## 2. Basis of preparation (continued)

### *(c) Functional and presentation currency*

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Company's functional currency.

### *(d) Use of estimates and judgments*

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Critical judgments in applying accounting policies and key estimates having the most significant effect on the amounts recognized in the condensed consolidated interim financial statements are discussed in the following notes:

- Note 3(f) – Inventories
- Note 3(g) – Impairment
- Note 3(j) – Warranty
- Note 3(k) – Revenue recognition
- Note 3(o) – Recognition of deferred tax asset

### *(e) Going concern*

These condensed consolidated interim 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 September 30, 2011, the Company had negative working capital of \$370,866 (December 31, 2010: positive working capital \$3,560,924), a deficit of \$48,464,977 (December 31, 2010: \$44,005,300), a net loss of \$4,459,677 and negative cash flow from operations of \$3,399,867.

The Company has incurred significant operating losses and negative cash flows from operations over the past years and has negative working capital due to its ability to obtain additional financing to fund its ongoing operations. The Company's ability to continue as a going concern is dependent upon attaining profitable operations and/or obtaining additional financing to fund its ongoing 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 projects, 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 condensed consolidated interim 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 statement of financial position items.

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements and in preparing the opening IFRS statement of financial position at January 1, 2010 for the purposes of the transition to IFRS, unless otherwise indicated.

These accounting policies have been applied consistently by AMA's subsidiaries.

#### *(a) Basis of consolidation*

##### *(i) Business combinations*

###### *Acquisitions on or after January 1, 2010*

For acquisitions on or after January 1, 2010, the Company will measure goodwill as the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree, less the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss.

The Company will elect on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognized amount of the identifiable net assets, at the acquisition date. Transaction costs, other than those associated with the issue of debt or equity securities, that the Company incurs in connection with a business combination will be expensed as incurred.

To date, there have been no acquisitions since the purchase of Wingspeed Corp.

###### *Acquisitions prior to January 1, 2010*

As part of its transition to IFRS, AMA elected not to restate the Wingspeed Corp. business combination that occurred in October 2009.

##### *(ii) Subsidiaries*

Subsidiaries are entities controlled by AMA. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Company.

These condensed consolidated interim financial statements consolidate the accounts of AMA and its wholly owned subsidiaries, FLYHT Inc., AeroMechanical Services USA Inc., FLYHT Corp., FLYHT India Corp and TFM Inc. The latter four subsidiaries are inactive.

##### *(iii) Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

### 3. Significant accounting policies (continued)

#### *(b) Foreign currency*

##### *(i) Foreign currency transactions*

Foreign currency transactions are translated to Canadian dollars at the exchange rate in effect on the transaction date. Foreign currency denominated monetary assets and liabilities at each reporting date are retranslated to the functional currency at the exchange rate in effect on that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate in effect on the date of the transaction.

##### *(ii) Foreign operations*

The assets and liabilities of foreign operations are translated to Canadian dollars at exchange rates in effect at the reporting date. The income and expenses of foreign operations are translated to Canadian dollars at exchange rates in effect on the transaction dates.

Foreign currency differences are recognized in other comprehensive income in the cumulative translation account.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income in the cumulative amount of foreign currency translation differences.

#### *(c) Financial instruments*

##### *(i) Non-derivative financial assets*

The Company initially recognizes loans, receivables and deposits on the date they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

##### Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise trade and other receivables. Cash and cash equivalents consist of bank deposits.

### 3. Significant accounting policies (continued)

#### (c) Financial instruments (continued)

##### (ii) Non-derivative financial liabilities

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

The Company has the following non-derivative financial liabilities: debentures, trade payables, accrued liabilities, loans and borrowings, and finance lease obligations.

These financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

##### (iii) Share capital

###### Common shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

###### Warrants

Warrants are classified as equity. Incremental costs directly attributable to the issue of warrants are recognized as a deduction from equity, net of any tax effects.

The fair value of warrants is estimated using the Black-Scholes option pricing model.

##### (iv) Compound financial instruments

Compound financial instruments issued by the Company comprise convertible secured subordinate debentures that can be converted to common shares at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

Interest, dividends, losses and gains relating to the financial liability are recognized in profit or loss. Distributions to the equity holders are recognized in equity, net of any tax benefit.

### 3. Significant accounting policies (continued)

#### (d) Property and equipment, intangible assets

##### (i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset including those that are directly attributable to bringing the asset to the location and working condition for its intended use.

Software that is integral to the functionality of the related equipment is recognized as property and equipment, otherwise it is considered an intangible asset.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment. Net gains are recognized in other income and net losses are recognized in other expenses.

##### (ii) Subsequent costs

The cost of replacing a part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

##### (iii) Depreciation

Depreciation is calculated using the depreciable amount, which is the cost of an asset less its residual value. Depreciation is recognized in profit or loss at rates calculated to write-off assets over their estimated useful lives since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

The depreciation rates are as follows:

Computers	30% declining balance
Software	12 months straight line
Equipment	20% declining balance
Leasehold improvements	Term of lease (5 years)

Estimates of depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate. Any changes in these estimates are accounted for prospectively.

### 3. Significant accounting policies (continued)

#### *(d) Property and equipment, intangible assets (continued)*

##### *(iv) Research and development*

Expenditure on research activities is expensed as incurred.

Research and development costs consist primarily of consulting expenses and parts related to the design, testing, and manufacture of AFIRS and the design and testing of UpTime, FIRST, FLYHTStream, and FLYHT Fuel Management System. Other research and development costs include testing and certification.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use, and borrowing costs on qualifying assets for which the commencement date for capitalization is on or after January 1, 2010. Other development expenditure is recognized in profit or loss as incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

##### *(v) Other intangible assets*

Other intangible assets that are acquired by the Company and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

Acquired intangible assets with indefinite useful lives are stated at cost and are not amortized.

An intangible asset is derecognized on disposal or when no future economic benefits are expected from its use or disposal.

##### *(vi) Subsequent expenditure*

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditures on internally generated goodwill and brands, are recognized in profit or loss as incurred.

##### *(vii) Amortization*

Amortization is calculated based on the asset's cost less its residual value.

Customer contracts and relationships are amortized over the remaining life of the contracts that were assumed on acquisition of Wingspeed Corporation's assets (residual value is zero). This method most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets. The useful initial lives for the current and comparative periods range from two to four years as per the terms of the contracts.

The license with Bombardier that allows AMA access to technical documents has an indefinite life and is not amortized. The license never expires. The Company presently has dealings with Bombardier and sees no end to that relationship.

Estimates of amortization methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate. Any changes in these estimates are accounted for prospectively.

### 3. Significant accounting policies (continued)

#### *(e) Leased assets*

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for according to the accounting policy applicable to that asset. Other leases are operating leases and the Company does not recognize the leased assets in its statement of financial position. Initial direct costs for operating leases are expensed immediately by the lessee.

As a lessee, AMA has several finance leases for computer hardware, software and equipment.

As a lessee, AMA has only one operating lease, for its premises.

As a lessor, rental assets are recorded at cost in AMA's statement of financial position and consist of AFIRS units that are leased and in use in customer aircraft under lease type agreements. Depreciation is provided for active leased units on a straight-line basis over nine years. Spare units at customer sites are not depreciated until swapped into service.

#### *(f) Inventories*

Inventories are measured at the lower of cost and net realizable value. The cost of inventories includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. The amount of inventory that is expected to be recovered more than 12 months after the reporting date is presented as a non-current asset.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. Any writedown to net realizable value is recognized as an expense. Reversals of previous writedowns are recognized in profit or loss in the period when the reversal occurs.

AFIRS material inventories include general parts which are held pending installation and sales to customers. The weighted average cost method is used.

The carrying cost of AFIRS completed units includes raw material component costs plus a standard labour allocation. AFIRS completed inventory consists of AFIRS units that have been assembled and are held pending sale to customers. The weighted average cost method is used for components, while the labour component allocated to each unit is valued using the standard cost method.

Installations-in-progress includes product costs, and other direct project costs. When the system is fully functional, the installations-in-progress balance is recognized as cost of sales to correspond with the full unearned revenue amount then recognized as revenue.

The production of Underfloor Stowage Units is outsourced and the weighted average cost method is used.

### 3. Significant accounting policies (continued)

#### *(g) Impairment*

##### *(i) Financial assets (including receivables)*

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Company on terms that the Company would not consider otherwise, or indications that a debtor will enter bankruptcy.

The Company assesses impairment of each customer's receivable balance by analyzing historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss regarding a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

##### *(ii) Non-financial assets*

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For intangible assets that have indefinite useful lives, the recoverable amount is estimated at year end. The Company's non-financial assets that are subject to impairment include: property and equipment, rental assets, and intangible assets.

The recoverable amount of an asset (the "cash-generating unit", or "CGU") is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. The Company's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs.

An impairment loss is recognized in profit or loss if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment loss been recognized.

### 3. Significant accounting policies (continued)

#### *(h) Employee benefits*

##### *(i) Short-term employee benefits*

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The Company follows accrual accounting for wages, salaries, commissions and variable compensation payments. The commission policy outlines how commissions are calculated and when payment is made to employees.

##### *(ii) Share-based payment transactions*

The grant date fair value of share-based payment awards granted to employees is recognized as an expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards.

Share-based payment transactions are equity-settled. Share options granted to directors and employees are measured using the fair value of the equity instruments granted at the grant date which is determined using the Black-Scholes option pricing model.

If options are promised to an employee before the grant date, the Company recognizes the expense at the service commencement date based on fair value. Once the grant date is established, the earlier estimate is revised so that the expense is recognized based on the actual grant date fair value.

AMA estimates the expected forfeiture rate at the option grant date and updates the estimate over time as new information becomes available. Forfeitures may occur if employees terminate their employment before the options vest.

#### *(i) Share-based payment transactions to non-employees*

##### *(i) Stock options granted to consultants*

The Company grants stock options to consultants. These share-based payment transactions are equity-settled. Transactions with non-employees are measured based on the fair value of the goods or services received, at the receipt date. Fair value is measured at the date the entity obtains the goods or the counterparty renders service.

AMA estimates the expected forfeiture rate at the option grant date and updates the estimate over time as new information becomes available. Forfeitures may occur if consultants do not fulfill their obligations before the options vest.

##### *(ii) Agent warrants*

When the Company issues common shares, warrants, and debentures through brokered private placements, agent warrants are issued to the agents as consideration for their services.

Warrants are classified as equity. Incremental costs directly attributable to the issue of warrants are recognized as a deduction from equity, net of any tax effects.

The fair value of warrants is estimated using the Black-Scholes option pricing model.

### 3. Significant accounting policies (continued)

#### *(j) Provisions*

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance cost.

#### *(i) Warranties*

The Company warrants that the AFIRS products shall be free of defects during the term of each agreement and any renewals. Also, AMA warrants that it will deliver all data services required by the customer accurately and on-time. A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data.

#### *(k) Revenue*

##### *(i) Installation kits*

###### *(a) Sales type agreements*

AFIRS fees from sales type service agreements are deferred as unearned revenue and corresponding expenses are recorded as an asset (installations in progress). Once the system (including the AFIRS unit and installation kit) is fully functional, the full deferred amount is recognized in revenue along with the installations in progress as cost of sales.

###### *(b) Lease type agreements*

The Company rents AFIRS units to some customers under operating leases. Under the terms of the lease agreements, the AFIRS units remain the property of AMA and title does not transfer to the customer nor is there an option for the customer to purchase the AFIRS unit at the end of the lease.

The upfront fee from leased AFIRS contracts is initially recorded as unearned revenue and recognized upon shipment of the AFIRS unit into revenue over the first term of the lease agreement.

##### *(ii) Voice and Data*

Revenue from UpTime usage fees is recognized at the end of each month and is based on actual usage during that month.

##### *(iii) Parts*

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable. Revenue is recognized when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

Revenue from the sale of Underfloor Stowage Units is recognized when the unit is shipped, title is transferred, and collection is reasonably assured.

##### *(iv) Technical Services*

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

### 3. Significant accounting policies (continued)

#### *(k) Revenue (continued)*

##### *(v) Other Income - Licensing Revenue*

License fees and royalties paid for the use of AMA's assets (i.e. trademarks, patents, and software) are recognized on an accrual basis.

#### *(l) Government Assistance*

##### *(i) Government Grants*

Government grants related to income are recognized in profit or loss to match the costs that they are intended to compensate when there is reasonable assurance that they will be received and the Company will comply with the conditions associated with the grant.

##### *(ii) Government Loans*

Low-interest or interest-free government loans are measured initially at their fair value and interest is imputed on the loan in subsequent periods. The benefit of the below-market interest rate is measured as the difference between the fair value of the loan on initial recognition and the amount received. This benefit is accounted for according to the type of grant.

#### *(m) Lease payments*

##### *(i) Operating lease payments*

Payments made under operating leases are recognized in profit or loss on an accrual basis over the term of the lease. Initial direct costs for operating leases are immediately expensed.

##### *(ii) Finance lease payments*

Minimum lease payments made under finance leases are apportioned between finance costs and a reduction of the outstanding liability. The finance cost is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

#### *(n) Finance income and finance costs*

Finance income comprises interest income which is recognized as it accrues in profit or loss, using the effective interest method. The Company earns income on its cash and cash equivalents (bank deposits) and its restricted cash (Guaranteed Investment Certificates). Interest is recognized when earned.

Finance costs comprise interest expense on borrowings, and unwinding of the discount on provisions.

Foreign currency gains and losses are reported on a net basis.

### 3. Significant accounting policies (continued)

#### *(o) Income tax*

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

When a taxable temporary difference arises from the initial recognition of the equity component separately from the liability component of a compound financial instrument, the resulting deferred tax liability is charged directly to the carrying amount of the equity component.

#### *(p) Earnings per share*

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined each period by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, for the effects of all dilutive potential common shares, which comprise debentures, share options, and warrants.

## 4. Unearned revenue

Unearned revenue classified as current consists of sales type agreements revenue that will be recognized when the system is fully functional, and rental type agreements revenue and license fees expected to be recognized as income in the next year.

Unearned revenue classified as non-current consists of the non-current portion of rental type agreements and license fees.

The license and manufacturing agreement with Sierra Nevada Corporation ("SNC") gives SNC the right to manufacture the Company's AFIRS product and market the AFIRS UpTime technology and products to the global military market. This license fee is deferred as unearned revenue and revenue is recognized on a straight-line basis over the five year term of the agreement.

All amounts recorded in unearned revenue are non-refundable.

	2011		2010	
Balance, beginning of year	\$	2,831,878	\$	3,123,842
Installation access fees		651,917		1,043,927
License fees		(193,140)		(193,140)
Earned revenues		(1,123,930)		(1,179,176)
Balance September 30		2,166,725		2,795,453
Less current portion		1,607,621		1,987,250
Non-current portion	\$	559,104	\$	808,203

## 5. Loans and borrowings

### *Government loans*

On February 23, 2011, the Company signed a contribution agreement with Industry Canada under the Strategic Aerospace and 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. Payments comprise 3.5% of the contribution and increase 15% yearly until April 30, 2028, when the final payment is 24.5% of the contribution. The amount to be repaid is 165% of the original contribution. At September 30, 2011 the Company had received \$223,033.

## 6. Capital and other components of equity

### *Common Shares*

	Number of Shares		Value	
Balance December 31, 2010		118,615,466	\$	36,730,844
Share issue cost recovery				3,913
Exercise of employee options		15,000		4,050
Contributed surplus from the exercise of employee options				2,685
Balance September 30, 2011		118,630,466	\$	36,741,492

## 6. Capital and other components of equity (continued)

### Stock option plan

	Number of shares	Weighted average exercise price
Outstanding December 31, 2010	2,498,977	\$ 0.39
Options granted	2,091,500	0.25
Options exercised	(15,000)	0.27
Outstanding September 30, 2011	4,575,477	\$ 0.33

### Warrants

	Number of warrants	Weighted average exercise price	Value
Outstanding December 31, 2010	29,655,609	\$ 0.73	\$ 5,134,018
Warrants expired	(7,999,999)	0.75	(2,240,000)
Outstanding September 30, 2011	21,655,610	\$ 0.72	\$ 2,894,018

### Contributed surplus

Balance December 31, 2010	\$ 3,750,114
Employee options exercised	(2,685)
Share based compensation	239,183
Warrants expired	2,240,000
Balance September 30, 2011	\$ 6,226,612

## 7. Operating segments

The Company has one operating segment.

### Geographical Information

The following revenue is based on the geographical location of customers.

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010	2011	2010
North America	\$ 484,906	\$ 442,902	\$ 1,609,081	\$ 1,839,966
South America	129,932	124,561	399,898	502,383
Africa / Middle East	673,162	234,400	1,374,366	456,355
Europe	48,369	18,518	130,018	29,051
Australasia	97,862	186,449	335,011	345,256
Asia	5,964	3,137	14,184	91,066
<b>Total</b>	\$ 1,440,195	\$ 1,009,967	\$ 3,862,558	\$ 3,264,077

All non-current assets (property and equipment and intangible assets) reside in Canada.

## Major customers

Revenues from the three largest customers represent approximately 41.7% (2010: 38.8%) of the Company's total revenues for the three months ended September 30 and 26.2% (2010: 30.0%) of the Company's total revenues for the nine months ended September 30.

## 8. Distribution expenses

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010	2011	2010
Salaries and benefits	\$ 403,048	\$ 516,963	\$ 1,335,858	\$ 1,722,001
Contract labour	206,884	160,922	573,299	457,801
Office	89,496	71,539	243,971	229,850
Travel	86,577	(1,800)	172,545	146,776
Equipment & maintenance	6,977	4,946	46,618	14,828
Marketing	21,724	5,277	57,533	41,792
Other	151	19	(7,558)	135,835
<b>Total</b>	<b>\$ 814,857</b>	<b>\$ 757,866</b>	<b>\$ 2,422,266</b>	<b>\$ 2,748,883</b>

## 9. Administration expenses

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010	2011	2010
Salaries and benefits	\$ 238,741	\$ 275,240	\$ 953,183	\$ 1,044,198
Contract labour	15,055	33,012	62,398	115,984
Office	76,410	112,788	240,252	266,303
Legal fees	53,588	76,440	97,032	206,999
Audit and accounting	24,154	76,701	101,537	162,443
Investor relations	33,734	18,924	109,598	74,957
Brokerage, stock exchange, and transfer agent fees	1,507	2,010	27,710	30,713
Travel	8,999	1,494	49,312	122,002
Equipment & maintenance	12,638	8,990	36,740	32,090
Depreciation	37,099	61,708	104,368	156,339
Other	5,329	3,668	12,722	11,184
<b>Total</b>	<b>\$ 507,254</b>	<b>\$ 670,975</b>	<b>\$ 1,794,852</b>	<b>\$ 2,223,212</b>

## 10. Research and development expenses

To date, all development costs have been expensed as incurred.

AMA received funding from the Industrial Research Assistance Program (“IRAP”) government grant through the National Research Council of Canada from August 17, 2009 to March 31, 2011. The Company received \$246,126 to develop the FLYHT Fuel Management System. The grant reimbursed a portion of AMA’s salary and contractor costs. This grant was classified as related to income. AMA used the net presentation approach by reducing compensation expense relating to research and development.

AMA also received \$223,033 from the Strategic Aerospace and Defense Initiative which is a repayable contribution. It was determined that the repayable contribution is at below market interest rates and therefore it was accounted for as a loan payable of \$80,666 and a grant of \$142,367. The grant portion reimbursed a portion of AMA’s costs related to the development of the AFIRS 228. This grant was classified as related to income. AMA used the net presentation approach by reducing research and development expenses.

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010	2011	2010
Salaries and benefits	\$ 424,796	\$ 197,884	\$ 964,136	\$ 645,167
Contract labour	523,682	1,439,989	1,690,613	3,262,527
Office	14,233	12,317	37,402	50,795
Travel	35,820	42,166	70,226	157,076
Equipment & maintenance	124,503	1,388	129,483	7,321
Components	137,000	51,436	150,618	129,481
Government grants	(142,367)	-	(232,398)	(34,151)
SRED tax credit	-	-	(355,982)	-
Other	500	102	2,171	1,722
<b>Total</b>	<b>\$ 1,118,167</b>	<b>\$ 1,745,282</b>	<b>\$ 2,456,269</b>	<b>\$ 4,219,938</b>

## 11. Finance income and finance costs

*Recognized in profit or loss:*

	For the three months ended September 30		For the nine months ended September 30	
	2011	2010	2011	2010
Interest income on bank deposits	\$ 4,063	\$ 3,271	\$ 22,392	\$ 14,420
Net foreign exchange gain	18,680	2,532	55,077	14,674
Finance income	22,743	5,803	77,469	29,094
Bank service charges	5,937	6,313	15,988	17,922
Interest expense	3,301	3,597	6,264	11,655
Government grant interest expense	124	-	124	-
Debenture interest expense	97,211	-	278,791	-
Debenture cost amortization	19,744	-	58,587	-
Finance costs	\$ 126,317	\$ 9,910	\$ 359,754	\$ 29,577

## 12. Earnings per share

### *Basic earnings per share*

The calculation of basic and diluted earnings per share for the three months ended September 30, 2011 was based on a weighted average number of common shares outstanding of 118,630,466 (2010: 103,609,082). The calculation for the nine months ended September 30, 2011 was based on a weighted average number of common shares outstanding of 118,624,697 (2010: 103,581,617).

## 13. Contingency

The Company is defending itself in an action for which the Company believes the amount of liability is undeterminable at this time. No liability has been accrued for claims on this action.

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. 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 2011, 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.

Based on legal advice, management does not expect the outcome of the action to have a material effect on the Company's financial position.

## 14. Related parties

During the first three quarters of 2011, the Company's transactions with a company owned by a director to supply consulting services and travel expenses totaled \$65,962, compared to \$70,147 in the first three quarters of 2010. The related party provides business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company. The Company also engaged in transactions in the second and third quarters of 2011 with a company owned by another director to supply consulting services, totaling \$25,377 (2010: nil). The related party provides business development services such as market analysis and corporate introductions related to the commercial aviation initiatives of the Company.

All of the transactions with these related parties were amounts that were agreed upon by the parties and approximated fair value. All other transactions with related parties were normal business transactions related to their positions within 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.

## 15. Explanation of transition to IFRS

These are the Company's third condensed consolidated interim financial statements prepared in accordance with IFRS.

The accounting policies set out in Note 3 have been applied in preparing the condensed consolidated interim financial statements for the three and nine months ended September 30, 2011, the comparative information presented in these condensed consolidated interim financial statements for the three and nine months ended September 30, 2010 and in the preparation of the opening IFRS statement of financial position at January 1, 2010 (the Company's date of transition).

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP. An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

## 15. Explanation of transition to IFRS (continued)

Reconciliation of equity as at September 30, 2010

	Canadian GAAP	Effect of transition	IFRS
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	\$ 1,711,328	\$ -	\$ 1,711,328
Restricted cash	250,000	-	250,000
Trade and other receivables	557,468	-	557,468
Deposits and prepaid expenses	129,340	-	129,340
Inventory (note 15.b)	2,296,166	(803,172)	1,492,994
<b>Total current assets</b>	<b>4,944,302</b>	<b>(803,172)</b>	<b>4,141,130</b>
<b>Non-current assets</b>			
Property and equipment	456,060	-	456,060
Rental assets	161,763	-	161,763
Intangible assets	375,025	-	375,025
Inventory (note 15.b)	-	803,172	803,172
<b>Total non-current assets</b>	<b>992,848</b>	<b>803,172</b>	<b>1,796,020</b>
<b>Total assets</b>	<b>\$ 5,937,150</b>	<b>\$ -</b>	<b>\$ 5,937,150</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	\$ 2,815,984	\$ -	\$ 2,815,984
Unearned revenue	1,987,250	-	1,987,250
Loans and borrowings	152,442	-	152,442
Finance lease obligations	92,715	-	92,715
<b>Total current liabilities</b>	<b>5,048,391</b>	<b>-</b>	<b>5,048,391</b>
Unearned revenue	808,203	-	808,203
Loans and borrowings	103,131	-	103,131
Finance lease obligations	85,539	-	85,539
Provisions	10,881	-	10,881
<b>Total non-current liabilities</b>	<b>1,007,754</b>	<b>-</b>	<b>1,007,754</b>
<b>Total liabilities</b>	<b>\$ 6,056,145</b>	<b>\$ -</b>	<b>\$ 6,056,145</b>
<b>Equity (deficit)</b>			
Share capital	\$ 35,597,678	\$ -	\$ 35,597,678
Warrants	2,729,314	-	2,729,314
Contributed surplus (note 15.a)	3,624,655	22,587	3,647,242
Accumulated other comprehensive Income (loss)	1,024	-	1,024
Deficit (note 15.a)	(42,071,666)	(22,587)	(42,094,253)
<b>Total equity (deficit)</b>	<b>(118,995)</b>	<b>-</b>	<b>(118,995)</b>
<b>Total liabilities and equity (deficit)</b>	<b>\$ 5,937,150</b>	<b>\$ -</b>	<b>\$ 5,937,150</b>

## 15. Explanation of transition to IFRS (continued)

Reconciliation of comprehensive income (loss) for the three months ended September 30, 2010

	Canadian GAAP	Effect of transition	IFRS
<b>Revenue</b>			
AFIRS UpTime sales	\$ 226,187	\$ -	\$ 226,187
AFIRS UpTime usage	674,572	-	674,572
Part sales	43,712	-	43,712
Services	65,496	-	65,496
<b>Total revenue</b>	<b>1,009,967</b>	<b>-</b>	<b>1,009,967</b>
<b>Cost of sales</b>	<b>501,433</b>	<b>-</b>	<b>501,433</b>
<b>Gross profit</b>	<b>508,534</b>	<b>-</b>	<b>508,534</b>
Other income	68,691	-	68,691
Distribution expenses	757,866	-	757,866
Administrative expenses (note 15.a)	666,616	4,359	670,975
Research and development expenses	1,745,282	-	1,745,282
<b>Results from operating activities</b>	<b>(2,592,539)</b>	<b>(4,359)</b>	<b>(2,596,898)</b>
Finance income	5,803	-	5,803
Finance costs	9,910	-	9,910
<b>Net finance costs</b>	<b>(4,107)</b>	<b>-</b>	<b>(4,107)</b>
<b>Loss for the period (note 15.a)</b>	<b>(2,596,646)</b>	<b>(4,359)</b>	<b>(2,601,005)</b>
Foreign currency translation differences	1,051	-	1,051
<b>Total comprehensive loss for the period</b>	<b>\$ (2,595,595)</b>	<b>\$ (4,359)</b>	<b>\$ (2,599,954)</b>
<b>Earnings (loss) per share</b>			
Basic and diluted earnings (loss) per share	\$ (0.03)	\$ -	\$ (0.03)

## 15. Explanation of transition to IFRS (continued)

*Reconciliation of comprehensive income (loss) for the nine months ended September 30, 2010*

	Canadian GAAP	Effect of transition	IFRS
<b>Revenue</b>			
AFIRS UpTime sales	\$ 990,317	\$ -	\$ 990,317
AFIRS UpTime usage	2,073,548	-	2,073,548
Part sales	83,434	-	83,434
Services	116,778	-	116,778
<b>Total revenue</b>	<b>3,264,077</b>	<b>-</b>	<b>3,264,077</b>
<b>Cost of sales</b>	<b>1,488,910</b>	<b>-</b>	<b>1,488,910</b>
<b>Gross profit</b>	<b>1,775,167</b>	<b>-</b>	<b>1,775,167</b>
Other income	197,451	-	197,451
Distribution expenses (note 15.a)	2,756,250	(7,367)	2,748,883
Administrative expenses (note 15.a)	2,205,417	17,795	2,223,212
Research and development expenses	4,219,938	-	4,219,938
<b>Results from operating activities</b>	<b>(7,208,987)</b>	<b>(10,428)</b>	<b>(7,219,415)</b>
Finance income	29,094	-	29,094
Finance costs	29,577	-	29,577
<b>Net finance costs</b>	<b>(483)</b>	<b>-</b>	<b>(483)</b>
<b>Loss for the period before income tax (note 15.a)</b>	<b>(7,209,470)</b>	<b>(10,428)</b>	<b>(7,219,898)</b>
Income tax	4,351	-	4,351
Net loss for the period	(7,213,821)	(10,428)	(7,224,249)
Foreign currency translation differences	1,024	-	1,024
<b>Total comprehensive loss for the period</b>	<b>\$ (7,212,797)</b>	<b>\$ (10,428)</b>	<b>\$ (7,223,225)</b>
<b>Earnings (loss) per share</b>			
Basic and diluted earnings (loss) per share	\$ (0.07)	\$ -	\$ (0.07)

### *Material adjustments to the statement of cash flows for 2010*

There are no material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under Canadian GAAP.

## 15. Explanation of transition to IFRS (continued)

### *Notes to the reconciliations*

#### (a.) Share-based payments

AMA qualified for the exemption under IFRS 1 and opted to use it. Therefore, the Company has not retrospectively applied IFRS 2 Share-based Payment to equity instruments that were granted after November 7, 2002 that vested before the transition date. IFRS 2 will apply to equity instruments granted after November 7, 2002 that vest after the transition date.

An adjustment was made to the opening IFRS statement of financial position for the options granted to the Howard Group. Under Canadian GAAP, these options were valued using the Black-Scholes pricing model; but under IFRS, the options are measured using the fair value of the services received by AMA.

An adjustment was made to the opening IFRS statement of financial position for the options promised to two employees before they were granted. At the service commencement date, AMA recognized the expense based on fair value. On the grant date, the commencement date estimate was revised so that the expense was recognized based on the actual grant date fair value.

As a result, deficit as at September 30, 2010 increased by \$22,587 and Contributed Surplus increased by the same amount.

#### (b.) Inventories

The statement of financial position shows a reclassification from current to non-current assets for the portion of inventory that is not expected to turnover in the 12 months following the Condensed Consolidated Statements of Financial Position date.

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President, Marlin Ventures Ltd.  
Partner, Geselbracht Brown  
Vice-President, Standen's Limited  
President and CEO, AeroFinance International Inc.  
President, General Aviation Company  
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