# THIRD QUARTER 2012

FLYHT AEROSPACE SOLUTIONS LTD.

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# LETTER TO SHAREHOLDERS

Welcome to the third quarter report to our shareholders. Our company continues to grow revenues year over year as well as quarter over quarter. We think that our shareholders will be happy with the reductions on the expense side of our business as we wrap up development on the 228B. Due to contributions received from SADI from the repayable investment they have made in the 228 program, we had a net recovery of Research and Development expenses in the third quarter. There will be additional R&D costs, albeit at a reduced level, as we complete the certification of the 228S. We are pleased that the units installed on customer aircraft this year are performing well. The list of approved STCs grows steadily to facilitate the installation of more aircraft and the activation of previously installed aircraft scheduled for the fourth quarter. We currently have more than 30 installation kits delivered to customers and ready to commence service.

On the inventory front, we are in the final steps of selecting a contract manufacturing organization to build, test, and deliver our AFIRS 228 units and kits directly to our customers. Over the next 12 months, this will help us reduce our inventory as well as ensure the ability of our organization to deliver the number of units we anticipate needing. It is interesting to note that we have purchased enough major components to assemble 60 AFIRS 228B and 10 AFIRS 228S units as well as the major components to build an additional roughly 100 AFIRS 220 units. The AFIRS 220 is still in demand and we are confident that all units will be sold in the coming quarters.

Q3 is typically a slow quarter for news of new sales as most of our customers are extremely busy (or on holidays) during Q3. During the quarter, we received payments for 18 kits; shipped 20; and now have a total of 57 aircraft delivered this year. We look forward to a strong finish to the year.

The company has had a lot of activity in Western Africa over the last few quarters and this quarter we delivered a Safety Management System to the Nigerian Civil Aviation Authority and a FLYHT team went over in early Q4 to install, train and commission the system. We are looking for good things to come from that part of the world in coming quarters.

We also had some long waited albeit slow progress in the Far East. We delivered 4 units to a customer in China directly from the factory. There is more activity anticipated in Q4 from China and we believe that a slow start to the long anticipated roll out in China may be commencing. We are not forecasting numbers and have no formal information on what the adoption rate may be but we anticipate that we will finally seeing the market moving and progress made there, even though it may be in small increments at this point.

The funds raised in Q2 and early Q3 have been put to work buying inventory, cleaning up past due payables and we are managing our resources, especially cash, very carefully. We see the light at the end of the tunnel on cash flow break even and will continue to drive as quickly as possible to that, while at the same time protecting the programs underway with all of our customers to ensure that we maintain the high level of customer satisfaction we have with our current and new customers.

As always, we would like to thank our shareholders for their continued support, our staff for their above and beyond efforts and our customers for their loyalty. AFIRS is becoming a well known and respected product and we believe we are on the road to success.

Bill Tempany,
President and Chief Executive Officer

# MANAGEMENT DISCUSSION & ANALYSIS

This management discussion and analysis ("MD&A") is as of November 6, 2012 and should be read in conjunction with the condensed consolidated interim financial statements of FLYHT Aerospace Solutions Ltd. ("FLYHT" or the "Company") for the three and nine months ended September 30, 2012 and the accompanying notes. Additional information with respect to FLYHT can be found on SEDAR at www.sedar.com. The Company has prepared its September 30, 2012 condensed consolidated interim financial statements in accordance with IAS 34 Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB"). The Company's accounting policies are provided in note 3 to the condensed consolidated interim financial statements.

## Non-GAAP Financial Measures

The Company reports its financial results in accordance with International Financial Reporting Standards ("IFRS" or "GAAP"). It also occasionally uses certain non-GAAP financial measures, such as working capital, modified working capital, and loss before research and development ("R&D"). FLYHT 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 nonrefundable. Loss before R&D is defined as the net loss minus the direct costs associated with R&D. 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, R&D 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, R&D (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 but are not limited to production rates, timing for product deliveries and installations, Canadian, U.S., and foreign government activities, volatility of the aviation market for FLYHT'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

FLYHT is a designer, developer and service provider of innovative solutions to the global aerospace industry and markets and sells its products under the FLYHT™ brand name. The Company's solutions are designed to improve the productivity and profitability of its customers and enable communication between pilots and ground support. FLYHT's tools deliver data from the aircraft to operations groups on the ground, on demand. The Company's products are available for commercial, business and military aircraft. FLYHT's emergency data streaming program, FLYHTStream™, can stream position reports and data from an aircraft in flight to the airline in real time.

FLYHT's products and services, featured below, are marketed globally by a team of employees and agents based in Canada, the United States, China, the United Kingdom, Ireland, Abu Dhabi, and Argentina.

### AFIRS™ and UpTime™

FLYHT's Automated Flight Information Reporting System ("AFIRS") is a device installed on aircraft and monitors hundreds of essential functions from the plane and the black box. AFIRS sends the information to the UpTime server on the ground, which stores and relays the data to the airline in real time. Airlines 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. FLYHT also builds value added applications for operators such as FLYHTStream and the FLYHT Fuel Management System that run on the AFIRS hardware and its UpTime servers. FLYHT offers global satellite coverage, providing service to whoever needs it, when they need it, anywhere on the planet.

The AFIRS 220 has been FLYHT's signature product since 2004. The unit has received regulatory certification for installation in approximately 30 widely used commercial aircraft brands and models.

FLYHT's new AFIRS device, the 228B, continues to demonstrate its value in the marketplace. In October the AFIRS' remote configurable intelligence, an industry first, was used successfully to keep a client's aircraft reporting as per their specifications. This feature of the 228 will become increasingly important as clients around the globe adopt the AFIRS 228 technology.

The 228 incorporates improvements over the 220 in several important areas: processing capacity, data transmission characteristics and programmability. The 228's features cater to the evolving needs of airlines by providing a flexible product that is programmed for the information they need. AFIRS 228 is an addition to FLYHT's product line, not a replacement for the 220. The Company will continue to sell its AFIRS 220.

### FLYHTStream

On July 12, 2012 the BEA - the French Civil Aviation Safety Investigation Authority - published their final report on the June 1st 2009 accident of Air France **flight AF 447 from Rio de Janeiro to Paris.** In the report the BEA recommends *"...that EASA and ICAO make mandatory as quickly as possible, for airplanes making public transport flights with passengers over maritime or remote areas, triggering of data transmission to facilitate localisation as soon as an emergency situation is detected on board"*

FLYHT is the only aerospace company that has demonstrated the ability to fulfill the BEA's recommendation.
FLYHT's patent-pending technology FLYHTStream is a revolutionary new technology that performs real-time triggered alerting and black-box data streaming in the event of an emergency on the aircraft. FLYHTStream uses AFIRS' onboard logic and processing capabilities on the aircraft in combination with the UpTime's ground-based servers to interpret and route alerts and messages from the aircraft in trouble to parties on the ground that need to know such as the airline, operation centers and regulators.

### 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. FLYHT designed this unique application that highlights exceptions to best practices, provides quick drill downs to spot the root cause of issues, 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 stand-alone 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 are always within reach of the seated crew and 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-8s and can also be installed in other aircraft types.

### System Approvals

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

## Trends and Economic Factors

Since early this year global air travel expansion has been showing signs of slowing down. Since January of this year air travel markets have expanded by only 1.2%, which has been influenced by falling business confidence and slowing world trade growth.

Airlines have responded to weaker air travel and freight markets by slowing capacity expansion. Seasonally adjusted passenger load factors have declined since early 2012 but are still at relatively high levels, particularly in the US, providing some offset to pressures on profitability from the recent renewed rise in jet fuel prices.

In international markets, Asia-Pacific was one of the weakest regions. In August, the market was only 2.9% higher than a year ago, reflecting slow economic and trade growth. Despite facing recessionary conditions in a number of home markets, European airlines expanded the RPKs they carry at a 5.6% year-on-year rate. North American airlines saw a 0.5% contraction in demand in August compared to a year ago. The fastest growing region remained the Middle East, where airlines continue to gain market share on many long-haul markets.

In air freight markets, the signs of a minor recovery that were evident early in 2012 are fading. Global FTKs contracted 0.8% in August compared to a year ago. A decline in consumer confidence in major economies over recent months has weakened demand for air freighted consumer goods. IATA notes that further declines in business confidence, now at a 38-month low, as well as the slowdown in world trade suggest that growth in air travel and freight will likely weaken further over the next few months.

FLYHT received customer payment for 18 installation kits in the third quarter of 2012 compared to 18 in the third quarter of 2011. In addition, revenue was recognized for 14 installation kits in the third quarter of 2012 compared to nine in the same period of 2011. For further explanation on how the Company recognizes revenue view the revenue recognition cycle on page 9.

The weakening of the Canadian dollar relative to the U.S. dollar during the third quarter of 2012 versus the same quarter of 2011 had a positive impact on the Company's revenue and income compared to the same quarter of 2011. As a result of these movements, the Company's revenues, which are substantially all denominated in U.S. dollars, were higher than they would have been had the foreign exchange rates not changed. It is the standard of the aviation industry to conduct business in U.S. dollars. While an amount of the Company's costs are denominated in Canadian dollars, a significant portion of the cost of sales, marketing and component costs are U.S. dollar denominated, and therefore create a natural hedge against fluctuations of the Canadian dollar.[1]

## Achievements of Q3 2012

On July 4, 2012, the fourth and final tranche of the private placement closed at a price of $0.20 per unit for proceeds of $981,000.

On July 23, 2012, FLYHT received the first certification for the AFIRS 288 deployment in China from the Civil Aviation Authority of China.

On August 21, 2012, the Company announced that the Howard Group Inc. had been appointed as investor relations advisors effective September 1, 2012.

On September 4, 2012, FLYHT announced that European certification had been received for the AFIRS 228 for the Hawker Beechcraft 750/800XP/850XP/900XP series aircraft from the European Aviation Safety Agency. This approval would allow for the immediate activation of the AFIRS technology on the Netjets Europe Hawker fleet contract which was announced on March 27, 2012.

On September 18, 2012, the Company announced a proposed non-brokered private placement for up to 1,000,000 million common shares at a price of $0.20 per common share.

On September 27, 2012, the non-brokered private placement closed at a price of $0.20 per common share for proceeds of $200,000.

[1] IATA Air Transport Analysis, August 2012

# RESULTS OF OPERATIONS – THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2012

## Quarterly Results

| | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 |
|---|---|---|---|---|
| AFIRS UpTime sales | $ 555,413 | $ 581,290 | $ 264,148 | $ 714,476 |
| AFIRS UpTime usage | 799,872 | 756,705 | 760,392 | 756,554 |
| Parts | 48,591 | 19,168 | 49,523 | 90,659 |
| Services | 145,885 | 227,312 | 41,106 | 42,952 |
| Revenue | 1,549,761 | 1,584,475 | 1,115,169 | 1,604,641 |
| | | | | |
| Loss | 133,102 | 1,954,303 | 2,174,901 | 2,083,371 |
| Loss (before R&D) | 290,563 | 1,183,274 | 961,742 | 1,213,147 |
| Loss per share (basic & fully diluted) | $ 0.00 | $ 0.02 | $ 0.02 | $ 0.02 |

| | Q3 2011 | Q2 2011 | Q1 2011 | Q4 2010 |
|---|---|---|---|---|
| AFIRS UpTime sales | $ 369,604 | $ 377,607 | $ 262,655 | $ 287,589 |
| AFIRS UpTime usage | 734,964 | 740,471 | 719,773 | 705,366 |
| Parts | 5,829 | 62,849 | 41,871 | 38,240 |
| Services | 329,798 | 119,984 | 97,153 | 389,850 |
| Revenue | 1,440,195 | 1,300,911 | 1,121,452 | 1,421,045 |
| | | | | |
| Loss | 1,576,944 | 1,397,442 | 1,485,292 | 1,753,251 |
| Loss (before R&D) | 458,777 | 841,827 | 702,805 | 210,917 |
| Loss per share (basic & fully diluted) | $ 0.01 | $ 0.01 | $ 0.01 | $ 0.02 |

## Liquidity and Capital Resource

The Company's cash at September 30, 2012 decreased to $1,408,588 from $1,928,065 at December 31, 2011. The Company has an available operating line of $250,000 that was undrawn at September 30, 2012. 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.

At September 30, 2012, the Company had negative working capital of $2,440,458 compared to negative $2,947,863 as of December 31, 2011, an improvement of $507,405. 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, 2012 would be positive $1,270,371 compared to negative $327,224 at December 31, 2011.

| | September 30, 2012 | December 31, 2011 | Variance |
|---|---|---|---|
| Cash and cash equivalents | $ 1,408,588 | $ 1,928,065 | $ (519,477) |
| Restricted cash | 250,000 | 250,000 | - |
| Trade and other receivables | 1,290,641 | 680,886 | 609,755 |
| Deposits and prepaid expenses | 128,026 | 199,076 | (71,050) |
| Inventory | 1,596,434 | 975,298 | 621,136 |
| Trade payables and accrued liabilities | (4,058,823) | (4,903,537) | 844,714 |
| Unearned revenue | (2,677,216) | (1,639,684) | (1,037,532) |
| Loans and borrowings | (356,460) | (384,815) | 28,355 |
| Finance lease obligations | (19,088) | (48,715) | 29,627 |
| Provisions | (2,560) | (4,437) | 1,877 |
| **Working capital** | **$ (2,440,458)** | **$ (2,947,863)** | **$ 507,405** |
| | | | |
| **Modified working capital** | **$ 1,270,371** | **$ (327,224)** | **$ 1,597,595** |

As of September 30, 2012, the Canadian equivalent of the Company's outstanding accounts payable to Sierra Nevada Corporation ("SNC") was $1,766,729 (December 31, 2011: $1,831,965) relating to their involvement with the development of the AFIRS 228. If this amount was removed from the working capital it would be negative $673,729 at September 30, 2012 and negative $1,115,898 at December 31, 2011. As well, the modified working capital would be a positive $3,037,100 at September 30, 2012 and positive $1,504,741 at December 31, 2011. 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 FLYHT 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 third quarter of 2011, management of FLYHT reviewed the state of the core software development with SNC in order to develop a plan and prepare for the transition from a SNC deliverable to FLYHT 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 FLYHT's Calgary based contractors and staff. The transition occurred in February 2011, and as anticipated, the first customer test flight was completed before the end of 2011. Full certification has begun to meet the timelines required by our current customers and prospects. The current accounts payable amount outstanding of $1,766,729 is presently under dispute in the courts. See the Contingency section on page 19 for further clarification.

In four tranches in June and July 2012 the Company issued 20,749,700 share units pursuant to a combination of brokered and non-brokered private placements at $0.20 per share unit resulting in gross proceeds of $4,149,940. Each share unit consists of one common share and one-half share purchase warrant. Each full share unit warrant entitles the holder to acquire one common share at a price of $0.30 until 24 months after the issue date of the share purchase warrant. As at September 30, 2012 share purchase warrants outstanding totaled 10,374,850 from the four tranches: 4,595,750 will expire June 22, 2014; 1,437,500, June 27, 2014; 1,889,100, June 29, 2014 and 2,452,000 July 4, 2014. The net cash proceeds after issuance costs of the brokered and non-brokered private placements totaled $3,784,367. A further 1,223,509 agent warrants were issued which entitle the holder to acquire one common share at a price of $0.20 until 24 months after the issue date of the agent warrant. The expiry details are: 606,935, June 22, 2014; 8,750, June 27, 2014; 264,474, June 29, 2014; and 343,350 July 4, 2014.

On September 27, 2012 the Company issued 1,000,000 common shares at $0.20 per share in connection with a non brokered private placement for net cash proceeds of $198,115.

An additional 6,000 common shares were issued to directors, officers, employees and consultants on the exercise of options. The weighted average exercise price of these common shares was $0.25, resulting in cash proceeds of $1,500.

As at November 6, 2012, FLYHT's issued and outstanding share capital was 140,386,166.

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 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. It is the Company's intention to continue to fund operations by adding revenue and its resulting cash flow as well as continue to manage outgoing cash flows. If the need arises due to market opportunities, the Company may meet those needs via the capital markets. These material uncertainties may cast significant doubt upon the Company's ability to continue as a going concern.

## Revenue recognition cycle

FLYHT's revenue recognition occurs in a series of steps. The process begins with the receipt of customer deposits, shipment, installation and finally usage of the AFIRS product.

Customers are required to pay for installation kits prior to the planned shipment date. This prepayment is recorded as a customer deposit, which is recognized as an accrued liability upon receipt. Upon shipment of an installation kit, the customer deposit is reclassified to unearned revenue, where it will remain until the AFIRS UpTime solution has been installed and is fully functional, at which point the installation kit is recognized as AFIRS UpTime sales revenue.

When customers order spare parts or Underfloor Stowage Units a prepayment is required, which is recorded as a customer deposit. When the shipment of the ordered part or unit occurs, the customer deposits are recognized as revenue.

## Customer deposits

Customer deposits are amounts received for AFIRS UpTime sales and parts that have not yet been shipped to the customer, and services that have not yet been completed. These deposits are nonrefundable, and are included on the Statement of Financial Position ("SFP") in trade payables and accrued liabilities.

The chart below outlines the movement in the Company's customer deposits throughout the third quarter. Payment was received for 18 installation kits in the third quarter of 2012, equivalent to the payment for 18 received in the third quarter of 2011, bringing 2012 year-to-date ("YTD") total payments for installation kits to 61, compared to 28 in 2011.

| | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Opening balance | $ 1,500,432 | $ 482,698 | $ 1,017,734 | $ 980,955 | $ 527,457 | $ 453,498 |
| Payments received from customers | 685,095 | 1,018,756 | (333,661) | 2,498,679 | 1,303,993 | 1,194,686 |
| Moved to unearned revenue | (1,151,914) | (248,964) | (902,950) | (2,446,021) | (578,960) | (1,867,061) |
| **Balance, September 30** | **$ 1,033,613** | **$ 1,252,490** | **$ (218,877)** | **$ 1,033,613** | **$ 1,252,490** | **$ (218,877)** |

## Unearned revenue

The chart below outlines the movement in the Company's unearned revenue throughout the third quarter. Revenue was recognized for 14 installation kits in 2012's third quarter compared to nine in the third quarter of 2011. YTD, revenue has been recognized for 33 installation kits, as compared to 24 in the same period of 2011.

| | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Opening balance | $ 2,233,330 | $ 2,357,057 | $ (123,727) | $ 1,897,204 | $ 2,831,878 | $ (934,674) |
| AFIRS UpTime sales: shipped, not accepted | 1,151,914 | 248,964 | 902,950 | 2,446,021 | 578,960 | 1,867,061 |
| AFIRS UpTime usage: prepaid | 11,496 | 24,141 | (12,645) | 260,287 | 72,957 | 187,330 |
| AFIRS UpTime sales: revenue recognized | (555,413) | (369,604) | (185,809) | (1,400,851) | (1,033,411) | (367,440) |
| AFIRS UpTime usage: revenue recognized | (35,351) | (29,453) | (5,898) | (267,925) | (90,519) | (177,406) |
| License fees: revenue recognized | (64,380) | (64,380) | - | (193,140) | (193,140) | - |
| **Balance, September 30** | **$ 2,741,596** | **$ 2,166,725** | **$ 574,871** | **$ 2,741,596** | **$ 2,166,725** | **$ 574,871** |

# Revenue

For the revenue categories listed in the Revenue sources chart on the next page, **AFIRS Uptime sales** includes the income from an AFIRS hardware sale as well as the parts required to install the unit. **AFIRS Uptime usage** is the recurring revenue from customers' usage of data they receive from AFIRS and use of functions such as the satellite phone. **Parts** revenue includes the sale of spare AFIRS units, spare installation parts, and Underfloor Stowage Units.

**Services** revenue includes technical services, repairs and expertise the Company offers such as the installation of operations control centres, such as the two FLYHT set up in Nigeria.

Overall, total revenue increased 7.6% from $1,440,195 in the third quarter of 2011 to $1,549,761 in the same period of 2012. AFIRS Uptime sales increased by 50.3%, AFIRS Uptime usage increased by 8.8% and Parts sales increased by 733.6%. These were offset by a decrease in Services revenue of 55.8%.

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. At September 30, 2012, there was one customer with a rental type contract (2011: two customers). 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 nonrefundable.

## Revenue sources

| | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| AFIRS UpTime sales | $ 555,413 | $ 369,604 | $ 185,809 | $ 1,400,851 | $ 1,009,866 | $ 390,985 |
| AFIRS UpTime usage | 799,872 | 734,964 | 64,908 | 2,316,969 | 2,195,208 | 121,761 |
| Parts | 48,591 | 5,829 | 42,762 | 117,282 | 110,549 | 6,733 |
| Services | 145,885 | 329,798 | (183,913) | 414,303 | 546,935 | (132,632) |
| **Total** | **$1,549,761** | **$1,440,195** | **$ 109,566** | **$ 4,249,405** | **$ 3,862,558** | **$ 386,847** |

The Company's long-term investment in marketing and relationship building has created a strong pipeline of prospective clients around the world. The revenue breakdown based on geographical location is displayed in the next table. Approximately 51.6% of the Company's revenue in the third quarter of 2012 was recurring, compared to 51.0% in the third quarter of 2011. Recurring revenue from FLYHT's existing client base is expected to continue to expand throughout 2012 and future years.

## Geographical sources of revenue

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

| | Q3 2012 | Q3 2011 | YTD 2012 | YTD 2011 |
|---|---|---|---|---|
| North America | $ 883,773 | $ 484,906 | $ 2,359,434 | $ 1,609,081 |
| South/Central America | 180,148 | 129,932 | 384,989 | 399,898 |
| Africa/Middle East | 325,711 | 673,162 | 912,549 | 1,374,366 |
| Europe | 8,088 | 48,369 | 137,212 | 130,018 |
| Australasia | 157,658 | 97,862 | 385,479 | 335,011 |
| Asia | (5,617) | 5,964 | 69,742 | 14,184 |
| **Total** | **$ 1,549,761** | **$ 1,440,195** | **$ 4,249,405** | **$ 3,862,558** |

| | Percent Q3 2012 | Percent Q3 2011 | Percent YTD 2012 | Percent YTD 2011 |
|---|---|---|---|---|
| North America | 57.1% | 33.7% | 55.5% | 41.5% |
| South/Central America | 11.6% | 9.0% | 9.1% | 10.4% |
| Africa/Middle East | 21.0% | 46.7% | 21.5% | 35.6% |
| Europe | .5% | 3.4% | 3.2% | 3.4% |
| Australasia | 10.2% | 6.8% | 9.1% | 8.7% |
| Asia | -0.4% | 0.4% | 1.6% | 0.4% |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

## Gross Margin and Cost of Sales

FLYHT's cost of sales include the direct costs associated with specific revenue types, including the AFIRS unit, installation kits, training and installation support, as well as associated shipping expenses and travel expenses for the Company's engineering personnel's on-site 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 2012 was 39.9% compared to 37.3% in 2011's third quarter. The increase was due to a difference in the mix of revenue sources, as AFIRS Uptime usage and Parts sales have higher margins than AFIRS Uptime sales. Gross margin will fluctuate quarter over quarter depending on customer needs and corresponding with the revenue type.

Gross margin for the last eight quarters was:

| Period | Gross Margin |
|---|---:|
| Q3 2012 | 60.1% |
| Q2 2012 | 43.7% |
| Q1 2012 | 54.8% |
| Q4 2011 | 40.2% |
| Q3 2011 | 62.7% |
| Q2 2011 | 59.8% |
| Q1 2011 | 56.0% |
| Q3 2010 | 66.7% |

## Operating Activities

### Other income

Other income consists of the recognition of the SNC license fee that was deferred as unearned revenue when received, and is being recognized over the initial five-year term of the agreement. See Contingency section on page 19.

## Distribution expenses

Consist of overhead expenses associated with the delivery of products and services to customers, sales and marketing.

| Major Category | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 450,918 | $ 403,048 | $ 47,870 | $ 1,365,402 | $ 1,252,125 | $ 113,277 |
| Share based compensation | 16,032 | - | 16,032 | 136,103 | 83,733 | 52,370 |
| Contract labour | 115,639 | 206,884 | (91,245) | 438,151 | 573,299 | (135,148) |
| Office | 79,396 | 89,496 | (10,100) | 264,570 | 243,971 | 20,599 |
| Travel | 65,655 | 86,577 | (20,922) | 250,368 | 172,545 | 77,823 |
| Equipment & maintenance | 12,706 | 6,977 | 5,729 | 26,451 | 46,618 | (20,166) |
| Depreciation | 13,237 | - | 13,237 | 39,675 | - | 39,675 |
| Marketing | 7,362 | 21,724 | (14,362) | 49,224 | 57,533 | (8,309) |
| Other | (6,109) | 151 | (6,260) | 56,617 | (7,558) | 64,175 |
| **Total** | **$ 754,836** | **$ 814,857** | **$ (60,021)** | **$ 2,626,561** | **$ 2,422,266** | **$ 204,295** |

**Salaries and benefits** increased throughout the third quarter ended September 30, 2012 and YTD numbers, compared with the same periods last year, mainly due to increased staffing requirements to meet ongoing needs of existing and future customers. The resulting overall increased costs were allocated between distribution and research and development expenses as a portion of the increased staff's efforts have been engaged in developing the AFIRS 228 and were expensed in Research and Development.

**Share based compensation** increased in the quarter and YTD due to an increase in the calculated fair value per share, and also increased YTD due to higher level of option grants to an increased base of distribution-related staff. This was combined with the recognition in 2012 of the partial vesting of options granted to one staff member in the fourth quarter of 2011.

**Contract labour** decreased in both the third quarter ended September 30, 2012 and YTD, compared with the same periods last year. There has been a reduction in contractors supplying distribution related services.

**Office** expenses increased YTD due to several factors, including YTD increases of $8,271 in postage and courier costs as the result of a new marketing campaign, $3,674 in training expenses, $2,216 in additional membership fees for industry groups that FLYHT has become involved with, $1,575 for income tax consulting relating to FLYHT Inc, and an increased rent allocation of $12,796. Offsetting these YTD increases was a decreased allocation of communication service costs. Quarterly differences were due to a decrease of $2,910 in training expenses, decreased memberships of $2,126, decreased allocation of communication services of $2,170, and a decreased rent allocation of $1,971. The allocation differences do not represent a change in FLYHT's overall expense.

**Travel** expenses increased YTD largely as the result of increased travel and meals associated with sales activities. The decrease in the third quarter versus the same quarter of 2011 was the result of the fluctuation in travel that occurs on a quarterly basis dependent on the need to have face to face meetings with potential customers. It is anticipated that as the AFIRS 228 is rolled out that travel expenses will continue to increase on a YTD basis but quarterly fluctuations will continue to occur.

**Equipment and maintenance** decreases YTD were due to costs associated with the movement of the UpTime hosting centre in 2011 to accommodate growth in the installation base that was not repeated in 2012. This decrease is partially offset in the current quarter by increased maintenance and costs associated with supporting the growth that prompted the 2011 move.

**Depreciation** expense increased in the quarter and YTD due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $26,281 and quarter to date by $11,049 due to a decrease in the need to acquire capital equipment.

**Marketing** expenses decreased in the quarter and YTD, due to the reduced requirement for marketing collateral throughout 2012 as well as a reduction in the number of tradeshows attended. The Company has analyzed the effectiveness of tradeshows and has targeted the most beneficial to the business objectives of the Company.

**Other** expenses increased from 2011 to 2012 due to an increased bad debt reserve of $70,405 against outstanding invoices mainly as the result of the Chapter 11 steps taken by three customers in the first quarter of 2012. In the third quarter, the additional allowance of $6,457 for the customer in the second quarter that appeared to be in financial difficulty was reversed as the full account balance was recovered.

## Administration expenses

Consist of expenses associated with the general operations of the Company that are not directly associated with delivery of services or sales.

| Major Category | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 259,513 | $ 238,068 | $ 21,445 | $ 894,112 | $ 804,513 | $ 89,599 |
| Share based compensation | 6,875 | 673 | 6,202 | 214,732 | 148,670 | 66,062 |
| Contract labour | 32,009 | 15,055 | 16,954 | 63,758 | 62,398 | 1,360 |
| Office | 81,312 | 76,410 | 4,902 | 245,904 | 240,252 | 5,652 |
| Legal fees | 23,252 | 53,588 | (30,336) | 127,210 | 97,032 | 30,178 |
| Audit and accounting | 25,000 | 24,154 | 846 | 83,305 | 101,537 | (18,232) |
| Investor relations | 21,643 | 33,734 | (12,091) | 60,459 | 109,598 | (49,139) |
| Brokerage, stock exchange, and transfer agent fees | 3,238 | 1,507 | 1,731 | 25,019 | 27,710 | (2,691) |
| Travel | 22,734 | 8,999 | 13,735 | 68,267 | 49,312 | 18,955 |
| Equipment and maintenance | 15,329 | 12,638 | 2,691 | 42,425 | 36,740 | 5,685 |
| Depreciation | 7,217 | 37,099 | (29,882) | 21,634 | 104,368 | (82,734) |
| Other | 4,290 | 5,329 | (1,039) | 9,914 | 12,722 | (2,808) |
| **Total** | **$ 502,412** | **$ 507,254** | **$ (4,842)** | **$1,856,739** | **$1,794,852** | **$ 61,887** |

**Salaries and benefits** increased throughout the third quarter and the YTD period ended September 30, 2012 compared with the same period last year, mainly due to an increased number of employees hired in the later portion of 2011 in the operations group to meet increased operations and production requirements.

**Share based compensation** increased in the quarter and YTD due to a higher level of option grants combined with an increase in the calculated fair value per share. This was combined with the recognition in 2012 of the partial vesting of options granted to an investment relations advisor in the third quarter of 2012.

**Contract labour** increased in the quarter due to the engagement in mid-2012 of a consultant working to identify new corporate opportunities, which was offset YTD mainly as the result of the rebuild of FLYHT's website in 2011 that was not repeated in 2012, along with the decreased need for support relating to the conversion to IFRS.

**Office** expenses increased in both the third quarter and YTD. The quarter's increase was due to increased training expenses of $5,562, increased insurance premiums of $3,893 and an increased rent allocation of $1,773, offset by decreased office supplies of $6,797. YTD increases included insurance expense of $11,679, an increased allocation of communication costs of $6,999, and increased training expenses of $3,689, offset by YTD decreases of $10,963 in office supplies and a decreased rent allocation of $5,351.

**Legal fees** increased YTD as the result of legal services required with regards to research on international business processes and the implementation of the appropriate policies and documentation, along with the legal documentation required as a result of FLYHT's legal name change, and legal services required for closure of legal proceedings. The decrease in Q3 expenses are mainly due to the Q2 2012 closure of legal proceedings.

**Audit and accounting** expense YTD decrease is due to the requirement for increased support during the 2011 transition to IFRS that was not needed in 2012, together with a decrease in audit fees.

**Investor relations** expenses decreased both in the quarter and YTD due to the disengagement of IR consultants used in 2011 and the focus on using internal resources. This decrease is not expected to continue, due to the reengagement of an IR consultant near the end of the third quarter 2012.

**Travel** expenses increased in the quarter and YTD as a result of increased travel related to investor relations, and related to operations staff attendance at industry meetings. It is anticipated that with the roll out of an investor outreach program in conjunction with the engagement of an investor relation advisor, travel expenses will increase over future quarters.

**Equipment and maintenance** increases are due to the increased requirement for maintenance on administrative-related equipment in 2012, including the third quarter.

**Depreciation** expense decreased in the quarter and YTD due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $26,281 and quarter to date by $11,049 due to a decrease in the need to acquire capital equipment.

## Research and development expenses (recovery)

| Major Category | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 381,683 | $ 424,796 | $ (43,113) | $ 1,242,704 | $ 957,356 | $ 285,348 |
| Share based compensation | - | - | - | 12,615 | 6,780 | 5,835 |
| Contract labour | 284,491 | 523,682 | (239,191) | 1,196,896 | 1,690,613 | (493,717) |
| Office | 32,212 | 14,233 | 17,979 | 268,480 | 37,402 | 231,078 |
| Travel | 20,044 | 35,820 | (15,776) | 46,140 | 70,226 | (24,086) |
| Equipment & maintenance | 11,343 | 124,503 | (113,160) | 35,281 | 129,483 | (94,202) |
| Components | 32,558 | 137,000 | (104,442) | (2,642) | 150,618 | (153,260) |
| Government grants | (566,438) | (142,367) | (424,071) | (630,575) | (232,398) | (398,177) |
| SRED credit | (358,950) | - | (358,950) | (358,950) | (355,982) | (2,968) |
| Depreciation | 5,596 | - | 5,596 | 16,778 | - | 16,778 |
| Other | - | 500 | (500) | - | 2,171 | (2,171) |
| **Total** | **$ (157,461)** | **$ 1,118,167** | **$ (1,275,628)** | **$ 1,826,727** | **$ 2,456,269** | **$ (629,542)** |

**Salaries and benefits** expended on research and development decreased throughout the third quarter ended September 30, 2012 compared with the same period last year, as the 228B moved toward full production. An increase YTD remains, as Company staff was utilized to replace contractor resources throughout the later portion of 2011 and into the first nine months of 2012. It is anticipated that with the scheduled certification of the AFIRS 228 in the upcoming quarters that staffing levels will increase.

**Share based compensation** increased YTD due to higher level of option grants to a larger base of staff, combined with an increase in the calculated fair value per share.

**Contract labour** decreased from 2011, mainly as the result of reduced utilization of consultants for hardware development. With the certification phase of the AFIRS 228 in the following quarters the requirement for consultants will increase in order to obtain the necessary skills and experience to certify the product.

**Office** expenses increased both in the quarter and YTD, as a result of increased costs associated with patent applications relating to the AFIRS 228 and other initiatives as well as legal fees associated with the SNC legal action.

**Travel** expenses decreased due to bringing the AFIRS 228 in-house and the resulting reduction in need to travel to contractor sites.

**Equipment and maintenance** decreases are due to a decreased requirement to purchase software and equipment directly related to AFIRS 228 development.

**Components** decreased both in the quarter and YTD, as a result of the movement of parts purchased for the development of the AFIRS 228B to inventory as the remaining parts are no longer required for development but are being used in the production of units for customers.

**Government grants** increase YTD is due to differences in funding received in 2011 versus 2012. The $630,575 shown in 2012 and $142,367 shown in Q3 2011 are the portion of funds received that has been accounted for as a grant from the Strategic Aerospace and Defence Initiative ("SADI") grant, while the additional $90,031 in 2011 was received from the Industrial Research Assistance Program ("IRAP") program.

**SRED credit** difference between the third quarters of 2011 and 2012 is the result of a timing difference. Funds for the 2010 SRED credit were accounted for in the second quarter of 2011, while funds expected to be received for the 2011 SRED credit have been recorded in Q3 2012. Timing of receipt of these funds is dependent on when the Canada Revenue Agency completes their assessment.

**Depreciation** expense increased in the quarter and YTD due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $26,281 and quarter to date by $11,049 due to a decrease in the need to acquire capital equipment.

## Net finance costs

| Major Category | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Interest income | $ 1,875 | $ 4,063 | $ (2,188) | $ 1,947 | $ 22,392 | $ (20,445) |
| Net foreign exchange gain | 118,216 | 18,680 | 99,536 | 42,474 | 55,077 | (12,603) |
| Bank service charges | 4,989 | 5,937 | (948) | 15,431 | 15,988 | (557) |
| Interest expense | 3,765 | 3,301 | 464 | 10,659 | 6,264 | 4,395 |
| Government grant accretion | 18,135 | 124 | 18,011 | 42,188 | 124 | 42,064 |
| Debenture interest | 102,385 | 97,211 | 5,174 | 296,214 | 278,791 | 17,423 |
| Debenture cost amortization | 19,744 | 19,744 | - | 58,802 | 58,587 | 215 |
| **Net finance costs** | **$ (28,927)** | **$ (103,574)** | **$ 74,647** | **$ (378,873)** | **$ (282,285)** | **$ (96,588)** |

**Interest income** decreased in the quarter and YTD as a result of decreased average cash balances in 2012 as compared to 2011.

**Net foreign exchange gains** were higher in the third quarter 2012 as compared to 2011 due to the relative strength of the Canadian dollar in relation to the U.S. dollar. YTD net gains were less in 2012 than 2011.

**Interest expense** increased YTD due to a combination of interest owing on a short-term loan and an increase in equipment leased.

**Government grant accretion** is the recognition of the interest component of the SADI grant.

**Debenture interest** YTD increase was the result of the increased interest accretion on the debentures issued in December 2010.

## Net loss

| Major Category | Q3 2012 | Q3 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Net loss | $ 133,102 | $ 1,576,944 | $ (1,443,842) | $4,262,307 | $ 4,459,677 | $ (197,370) |
| Net loss without R&D | $ 290,563 | $ 458,777 | $ (168,214) | $2,435,580 | $ 2,003,408 | $ 432,172 |

## Foreign Exchange

All international and a majority of domestic sales of the Company's products and services are denominated in U.S. dollars. Accordingly, the Company is susceptible to foreign exchange fluctuations. In Q3 2012, over 98% of the Company's gross sales were made in U.S. dollars, unchanged from the third quarter of 2011. The Company expects this to continue since the aviation industry conducts the majority of its transactions in U.S. dollars, thus limiting the opportunity for sales in Canadian dollars or other major currencies. The Company also contracts in U.S. dollars for services and products related to cost of sales, which creates a natural hedge.

## Transactions with Related Parties

a) During the third quarter of 2012, the Company's transactions with a company owned by a director to supply consulting services and travel expenses totaled $22,335, compared to $22,145 in the third quarter of 2011. The related party provides business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company.

b) During the third quarter, the Company did not engage in transactions with a company owned by another director to supply consulting services that had been used throughout 2011 and the first quarter of 2012. The related party provides business development services such as market analysis and corporate introductions related to the commercial aviation initiatives of the Company.

| | **Included in contract labour:** | | | | **Included in accounts payable and accrued liabilities:** | |
|---|---|---|---|---|---|---|
| | **For the three months ended September 30** | | **For the nine months ended September 30** | | **September 30** | |
| | **2012** | **2011** | **2012** | **2011** | **2012** | **2011** |
| (a) | $ 22,335 | $ 22,145 | $ 67,481 | $ 65,962 | $ 14,807 | $ 14,984 |
| (b) | - | 18,780 | 17,984 | 25,377 | - | 13,777 |
| Total | $ 22,335 | $ 40,925 | $ 85,465 | $ 91,339 | $ 14,807 | $ 28,761 |

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 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.

## Contractual Obligations

The following table details the contractual maturities of financial liabilities, including estimated interest payments.

| September 30, 2012 | < 2 months | 2-12 months | 1-2 years | 2-5 years | > 5 years | Total |
|---|---|---|---|---|---|---|
| Accounts payable | $ 632,505 | $ - | $ - | * $ 1,766,729 | $ - | $ 2,399,234 |
| Compensation and statutory deductions | 85,538 | 303,990 | - | - | - | 389,528 |
| Finance lease liabilities | 4,058 | 20,291 | 20,116 | - | - | 44,465 |
| Accrued liabilities | 38,496 | 160,341 | - | - | - | 198,837 |
| Loans and borrowings | 17,202 | 339,258 | 323,088 | 3,659,938 | 246,604 | 4,586,090 |
| **Total** | **$ 777,799** | **$ 823,880** | **$ 343,204** | **$ 5,426,667** | **$ 246,604** | **$ 7,618,154** |

* See contingencies section on page 19.

In addition, the Company has repayment obligations related to three Government of Canada loan programs.

Under IRAP, the outstanding balance at September 30, 2012 was $84,628 compared to $151,296 at September 30, 2011. The initial amount is to be repaid as a percentage of gross revenues over a 5 to 10 year period commencing October 2005.

Under the Technology Partnerships Canada (“TPC”) program, the Company has an outstanding balance of $28,074 at September 30, 2012, compared to $47,186 at September 30, 2011. The initial amount is to be repaid based on 15% of the initial contribution, which equates to $19,122 per year for a 10 year repayment period. The yearly repayment is due if the Company has achieved more than a 10% increase in gross revenue over the previous year and the gross revenue exceeds the gross revenue that was set in fiscal 2004 of $556,127. The repayment period commenced January 1, 2005.

Under SADI, the Company has, at September 30, 2012, an outstanding repayable balance of $1,770,756. The amount is repayable over 15 years on a stepped basis commencing April 30, 2014. The initial payment on April 30, 2014 is 3.5% of the total contribution received and increases yearly by 15% until April 30, 2028 when the final payment is 24.5% of the total contribution received.

During the third quarters of both 2012 and 2011, FLYHT did not enter into any new lease agreements. Minimum lease payments are as follows for existing capital leases:

| Year | Total |
|---|---|
| 2012 | $ 6,087 |
| 2013 | 24,350 |
| 2014 | 14,028 |
| **Total** | **$ 44,465** |

The imputed interest included in the payments is $6,871 (2011 - $7,877) leaving a total obligation of $37,594 (2011 - $78,590).

## Contingencies

a) The Company took action against SNC and is defending itself against an action by SNC related to the development of the AFIRS 228. The Company has accrued a liability of $1,766,729, which represents the total amount of invoices received from SNC. The Company maintains that the claims are without merit and that the services invoiced were not provided. Management intends to vigorously defend the matter and believes the outcome will be in its favour.

   In November 2011, the Company formally notified SNC that they were in material breach of the License and Manufacturing Agreement that was entered into between the two parties on December 28, 2008. The Company demanded payment of $1,329,976 USD and $2,650,000 CDN and terminated the agreement. As well, the Company applied to the Alberta courts for arbitration under the provisions of the agreement. The courts granted the request for arbitration on November 29, 2011. Subsequent to the grant, SNC refused to recognize the jurisdiction of the court and has contested the cancellation of the agreement and the arbitration.

   In November 2011, SNC filed an action in Utah alleging that FLYHT failed to pay $2,042,000 USD.

   Based on legal advice and the accrual of the total amounts of invoices presented to the Company to date by SNC, management does not expect the outcome to have a material effect on the Company's financial position.

b) In the second quarter of 2012, a full and final settlement was reached with a Toronto-based company for the outstanding claims and counterclaims that were commenced in September 2007 alleging the Company induced a breach of contract and interfered with economic relationships. The parties agreed to dismiss existing litigation on a without cost basis with no admissions of liability. Therefore there were no amounts to be recorded.

## Recent Accounting Pronouncements

There have been no significant changes to accounting pronouncements as compared to those described in FLYHT's December 31, 2011 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 condensed consolidated interim financial statements there must be an accompanying notice indicating that the condensed consolidated interim financial statements have not been reviewed by an auditor.

The auditors of FLYHT Aerospace Solutions Ltd. have not performed a review of the condensed consolidated interim financial statements for the three and nine month periods ended September 30, 2012 and September 30, 2011.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (unaudited)

| | | September 30, 2012 | | December 31, 2011 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Cash | $ | 1,408,588 | $ | 1,928,065 |
| Restricted cash | | 250,000 | | 250,000 |
| Trade and other receivables | | 1,290,641 | | 680,886 |
| Deposits and prepaid expenses | | 128,026 | | 199,076 |
| Inventory | | 1,596,434 | | 975,298 |
| **Total current assets** | | 4,673,689 | | 4,033,325 |
| **Non-current assets** | | | | |
| Property and equipment | | 263,728 | | 336,660 |
| Rental assets | | 42,725 | | 127,867 |
| Intangible assets | | 97,272 | | 201,217 |
| Inventory | | 1,047,126 | | 810,640 |
| **Total non-current assets** | | 1,450,851 | | 1,476,384 |
| **Total assets** | $ | 6,124,540 | $ | 5,509,709 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Trade payables and accrued liabilities | $ | 4,058,823 | $ | 4,903,537 |
| Unearned revenue | | 2,677,216 | | 1,639,684 |
| Loans and borrowings | | 356,460 | | 384,815 |
| Finance lease obligations | | 19,088 | | 48,715 |
| Provisions | | 2,560 | | 4,437 |
| **Total current liabilities** | | 7,114,147 | | 6,981,188 |
| **Non-current liabilities** | | | | |
| Unearned revenue | | 64,380 | | 257,520 |
| Loans and borrowings | | 3,092,002 | | 2,486,199 |
| Finance lease obligations | | 18,506 | | 33,138 |
| Provisions | | 45,742 | | 47,027 |
| **Total non-current liabilities** | | 3,220,630 | | 2,823,884 |
| **Total liabilities** | | 10,334,777 | | 9,805,072 |
| **Equity (deficiency)** | | | | |
| Share capital (note 4) | | 39,885,708 | | 36,741,492 |
| Convertible debenture – equity feature | | 231,318 | | 231,318 |
| Warrants (note 4) | | 3,340,222 | | 2,499,778 |
| Contributed surplus | | 6,985,379 | | 6,622,606 |
| Accumulated other comprehensive income (loss) | | - | | - |
| Deficit | | (54,652,864) | | (50,390,557) |
| **Total equity (deficiency)** | | (4,210,237) | | (4,295,363) |
| **Total liabilities and equity (deficiency)** | $ | 6,124,540 | $ | 5,509,709 |

See accompanying notes to condensed consolidated interim financial statements.
Going concern (note 2e)
Contingencies (note 7)

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

| | For the three months ended September 30 | | For the nine months ended September 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Revenue (note 6) | $ 1,549,761 | $ 1,440,195 | $ 4,249,405 | $ 3,862,558 |
| Cost of sales | 617,776 | 537,667 | 2,013,626 | 1,553,822 |
| **Gross profit** | 931,985 | 902,528 | 2,235,779 | 2,308,736 |
| Other income | 64,380 | 64,380 | 193,140 | 193,140 |
| Distribution expenses | 754,836 | 814,857 | 2,626,561 | 2,422,266 |
| Administration expenses | 502,412 | 507,254 | 1,856,739 | 1,794,852 |
| Research and development expenses (recovery) | (157,461) | 1,118,167 | 1,826,727 | 2,456,269 |
| **Results from operating activities** | (103,422) | (1,473,370) | (3,881,108) | (4,171,511) |
| Finance income | 120,091 | 22,743 | 44,421 | 77,469 |
| Finance costs | 149,018 | 126,317 | 423,294 | 359,754 |
| **Net finance costs** | (28,927) | (103,574) | (378,873) | (282,285) |
| **Loss for the period before income tax** | (132,349) | (1,576,944) | (4,259,982) | (4,453,796) |
| Income tax expense | 753 | - | 2,325 | 5,881 |
| **Loss for the period** | (133,102) | (1,576,944) | (4,262,307) | (4,459,677) |
| Foreign currency translation | - | 6 | - | - |
| **Total comprehensive loss for the period** | $ (133,102) | $ (1,576,938) | $ (4,262,307) | $ (4,459,677) |
| **Earnings (loss) per share** | | | | |
| Basic and diluted loss per share (note 5) | $ (0.00) | $ (0.01) | $ (0.03) | $ (0.04) |

See accompanying notes to condensed consolidated interim financial statements.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY (DEFICIENCY) (unaudited)

For the nine months ended September 30, 2012 and 2011

| | Share Capital | Convertible Debenture | Warrants | Contributed Surplus | Foreign Currency Translation Reserve* | Deficit | Total Equity (Deficiency) |
|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2011** | $ 36,730,844 | $ 231,318 | $ 5,134,018 | $ 3,750,114 | $ - | $ (43,847,508) | $ 1,998,786 |
| Loss for the period | - | - | - | - | - | (4,459,677) | (4,459,677) |
| Foreign currency translation differences | - | - | - | - | - | - | - |
| **Total comprehensive loss for the period** | - | - | - | - | - | (4,459,677) | (4,459,677) |
| **Contributions by and distributions to owners** | | | | | | | |
| 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 |
| **Balance, September 30, 2011** | $ 36,741,492 | $ 231,318 | $ 2,894,018 | $ 6,226,612 | $ - | $ (48,307,185) | $ (2,213,745) |
| **Balance at January 1, 2012** | $ 36,741,492 | $ 231,318 | $ 2,499,778 | $ 6,622,606 | $ - | $ (50,390,557) | $ (4,295,363) |
| Loss for the period | - | - | - | - | - | (4,262,307) | (4,262,307) |
| Foreign currency translation differences | - | - | - | - | - | - | - |
| **Total comprehensive loss for the period** | - | - | - | - | - | (4,262,307) | (4,262,307) |
| **Contributions by and distributions to owners** | | | | | | | |
| Issue of common shares | 4,349,940 | | | | | | 4,349,940 |
| Share issue cost | (484,485) | | | | | | (484,485) |
| Bifurcation of warrants | (723,417) | | | | | | (723,417) |
| Issues of warrants | | | 840,444 | | | | 840,444 |
| Share-based payment transactions | - | - | - | 363,451 | - | - | 363,451 |
| Share options exercised | 2,178 | - | - | (678) | - | - | 1,500 |
| Total contributions by and distributions to owners | 3,144,216 | - | 840,444 | 362,773 | - | - | 4,347,433 |
| **Balance, September 30, 2012** | $ 39,885,708 | $ 231,318 | $ 3,340,222 | $ 6,985,379 | $ - | $ (54,652,864) | $ (4,210,237) |

*Accumulated other comprehensive income (loss)
See accompanying notes to condensed consolidated interim financial statements.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS (unaudited)

| | For the nine months ended September 30 | |
|---|---|---|
| | 2012 | 2011 |
| **Cash flows from operating activities** | | |
| Loss for the period | $ (4,262,307) | $ (4,459,677) |
| Adjustments for: | | |
| Depreciation | 78,087 | 104,368 |
| Depreciation of rental assets | 20,132 | 33,493 |
| Amortization of intangible assets | 103,945 | 103,945 |
| Convertible debenture accretion | 296,214 | 278,791 |
| Amortization of debenture issue costs | 58,802 | 58,587 |
| Government grant accretion | 42,188 | 124 |
| Government grant | (630,575) | (142,367) |
| Loss on sale of rental assets | 61,116 | - |
| Equity-settled share-based payment transactions | 363,451 | 239,183 |
| Change in inventories | (857,622) | 135,296 |
| Change in trade and other receivable | (612,585) | 82,826 |
| Change in deposits and prepaid expenses | 71,050 | (31,459) |
| Change in trade payables and accrued liabilities | (777,817) | 947,637 |
| Change in provisions | (3,162) | (4,146) |
| Change in unearned revenue | 844,392 | (665,153) |
| Unrealized foreign exchange | (32,328) | (63,015) |
| Interest income | (1,947) | (22,392) |
| Interest expense | 10,659 | 6,264 |
| **Net cash used in operating activities** | (5,228,307) | (3,397,695) |
| | | |
| **Cash flows from investing activities** | | |
| Acquisitions of property and equipment | (5,155) | (54,638) |
| Disposal (acquisitions) of rental assets | 3,894 | (5,156) |
| Interest received | 1,947 | 22,392 |
| **Net cash from (used in) used in investing activities** | 686 | (37,402) |
| | | |
| **Cash flows from financing activities** | | |
| Share issue (cost) recovery | (367,458) | 3,913 |
| Proceeds from issue of shares and warrants | 4,349,940 | - |
| Proceeds from exercise of share options and warrants | 1,500 | 4,050 |
| Proceeds from government grant | 879,854 | 223,033 |
| Repayment of loans and borrowings | (69,035) | (45,081) |
| Payment of finance lease liabilities | (44,259) | (39,557) |
| Interest paid | (10,659) | (6,264) |
| **Net cash from financing activities** | 4,739,883 | 140,094 |
| | | |
| **Net decrease in cash** | (487,738) | (3,295,003) |
| Cash at January 1 | 1,928,065 | 6,617,852 |
| Effect of exchange rate fluctuations on cash held | (31,739) | 168,423 |
| **Cash** | $ 1,408,588 | $ 3,491,272 |

See accompanying notes to condensed consolidated interim financial statements.

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

## 1. Reporting entity

FLYHT Aerospace Solutions Ltd. (the "Company" or "FLYHT") was founded in 1998 under the name AeroMechanical Services Ltd. The Company has been listed on the TSX Venture Exchange since March 2003, first as TSX.V: AMA. On May 10, 2012, the Company announced that shareholders approved a name change from AeroMechanical Services Ltd. to FLYHT Aerospace Solutions Ltd. On May 17, 2012 FLYHT received approval from the Toronto Stock Exchange to trade under the new symbol FLY. FLYHT is a public company incorporated under the Canada Business Corporations Act, and is domiciled in Canada. The Company's head office is 200W, 1144 – 29$^{th}$ 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, 2012 and 2011 consist of the Company and its subsidiaries.

FLYHT 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 FLYHT's products on every continent and the Company proudly serves more than 35 aircraft operators globally. FLYHT's headquarters are located in Calgary, Canada with representation in China, the Middle East, South America, the United States and Europe.

The consolidated financial statements of the Company as at and for the year ended December 31, 2011 are available upon request from the Company's registered office or at 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 and do not include all of the information required for full annual financial statements. These condensed consolidated interim financial statements were approved by the Board of Directors on November 6, 2012.

### (b) Basis of measurement

The condensed consolidated interim financial statements have been prepared on a 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").

### (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 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.

In preparing these condensed consolidated interim financial statements, the significant judgments made by management in applying the Company's accounting policies and key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended December 31, 2011.

## 2. Basis of preparation (continued)

### (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. As at September 30, 2012 and for the nine months then ended, the Company had negative working capital of $2,440,458, a deficit of $54,652,864, a net loss of $4,262,307 and negative cash flow from operations of $5,228,307.

The Company has incurred significant operating losses and negative cash flows from operations over the past years. 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 ("R&D") projects, and general economic conditions. It is the Company's intention to continue to fund operations by adding revenue and its resulting cash flow as well as continue to manage outgoing cash flows. If the need arises due to market opportunities the Company may meet those needs via the capital markets.

There is no assurance that the Company will be successful in attaining and sustaining profitable operations and cash flow 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. These material uncertainties may cast significant doubt upon the Company's ability to continue as a going concern.

## 3. Significant accounting policies

The accounting policies set out in FLYHT's December 31, 2011 consolidated financial statements have been applied consistently to all periods presented in these condensed consolidated interim financial statements, unless otherwise indicated. These accounting policies have also been applied consistently by FLYHT's subsidiaries.

## 4. Capital and Other Components of Equity

### *Share capital*

Authorized:

Unlimited numbers of common shares, and classes A, B and C preferred shares, issuable in series and have no par value.

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

## 4. Capital and Other Components of Equity (continued)

Issued and outstanding:

| Common shares: | Number of Shares | | Value |
|---|---|---|---|
| Balance January 1, 2011 | 118,615,466 | $ | 36,730,844 |
| Share issue cost recovery | - | | 3,913 |
| Exercise of employee options | 15,000 | | 4,050 |
| Contributed surplus from exercise of employee options | - | | 2,685 |
| Balance December 31, 2011 | 118,630,466 | $ | 36,741,492 |
| Issued for cash | 21,749,700 | | 4,349,940 |
| Share issue costs | | | (484,485) |
| Bifurcation of warrants | | | (723,417) |
| Exercise of employee options | 6,000 | | 1,500 |
| Contributed surplus from exercise of employee options | | | 678 |
| Balance September 30, 2012 | 140,386,166 | $ | 39,885,708 |

In four tranches on June 24, 26, 29, and July 4, 2012 the Company issued a total of 20,749,700 share units at $0.20 per share unit in connection with a brokered and non-brokered private placements resulting in gross proceeds of $4,149,940. Each share unit consists of one common share and one-half share purchase warrant. Each full share unit warrant entitles the holder to acquire one common share at a price of $0.30 until 24 months after the issue date of the share purchase warrant. As at September 30, 2012 share purchase warrants outstanding totaled 10,374,850 from the four tranches. The expiry details are: 4,595,750 will expire June 22, 2014; 1,437,500, June 27, 2014; 1,889,100, June 29, 2014; and 2,452,500 July 4, 2014. The net cash proceeds after issuance costs of these brokered and non-brokered private placements totaled $3,784,367. A further 1,223,509 agent warrants were issued which entitle the holder to acquire one common share at a price of $0.20 until 24 months after the issue date of the agent warrant. The expiry details are: 606,935, June 22, 2014; 8,750, June 27, 2014; 264,474, June 29, 2014; and 343,350 July 4, 2014.

On September 27, 2012 the Company issued 1,000,000 common shares at $0.20 per share in connection with a non brokered private placement for net cash proceeds of $198,115.

An additional 6,000 common shares were issued to directors, officers, employees and consultants on the exercise of options. The weighted average exercise price of these common shares was $0.25, resulting in cash proceeds of $1,500.

## 4. Capital and Other Components of Equity (continued)

### *Stock option plan*

The Company grants stock options to its directors, officers, employees and consultants. The Company has a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. As at September 30, 2012, there were 14,038,617 (2011: 11,863,047) common shares reserved for this purpose. All outstanding options issued to date vest immediately at the grant date with the exception of 1,000,000 options granted to an employee effective January 1, 2012 and 400,000 options granted to an investor relations consultant effective September 1, 2012, which have not yet vested (2011: 75,000). The options are granted at an exercise price not less than fair market value of the stock on the date of issuance. A summary of the Company's outstanding and exercisable stock options as at September 30, 2012 and 2011 and changes during these periods is presented below.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price** | **Number of options** | **Weighted average exercise price** |
| Outstanding, beginning of year | 4,485,991 | $ 0.28 | 2,498,977 | $ 0.39 |
| Options granted | 2,532,500 | 0.25 | 2,091,500 | 0.25 |
| Options exercised | (6,000) | 0.20 | (15,000) | 0.27 |
| Outstanding, September 30 | 7,012,491 | $ 0.27 | 4,575,477 | $ 0.33 |
| | | | | |
| Exercisable, September 30 | 5,612,491 | $ 0.28 | 4,500,477 | $ 0.33 |

Weighted average life remaining for the options outstanding and exercisable is 2.3 years. The exercise prices for options outstanding at September 30, 2012 were as follows:

| | All options | | Exercisable options | |
|---|---|---|---|---|
| Exercise price: | **Number** | **Weighted average remaining contractual life (years)** | **Number** | **Weighted average remaining contractual life (years)** |
| $0.20 | 1,000,000 | 1.25 | - | 1.25 |
| $0.25 | 2,045,000 | 2.25 | 2,045,000 | 2.25 |
| $0.25 | 2,532,500 | 3.25 | 2,132,500 | 3.25 |
| $0.27 | 428,331 | 0.25 | 428,331 | 0.25 |
| $0.41 | 790,000 | 1.25 | 790,000 | 1.25 |
| $0.41 | 150,000 | 0.25 | 150,000 | 0.25 |
| $0.50 | 66,660 | 0.25 | 66,660 | 0.25 |
| Total | 7,012,491 | 2.17 | 5,612,491 | 2.33 |

The weighted average fair value of the options granted during the first three quarters of the year was $0.14 (2011: $0.11). The fair value of the options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

| | **2012** | **2011** |
|---|---|---|
| Risk-free interest rate | 1.38% | 1.94% |
| Expected life (years) | 3.59 | 3.58 |
| Volatility in the price of the Company's common shares | 99% | 109% |
| Dividend yield rate | 0.00% | 0.00% |

## 4. Capital and Other Components of Equity (continued)

*Warrants*

| | Number of warrants | Weighted average exercise price | Value |
|---|---|---|---|
| Outstanding January 1, 2011 | 29,655,609 | $ 0.73 | $ 5,134,018 |
| Warrants expired | (9,119,999) | 0.72 | (2,634,240) |
| Outstanding December 31, 2011 | 20,535,610 | $ 0.47 | $ 2,499,778 |
| Issued on private placement | 10,374,850 | 0.30 | 723,417 |
| Agent warrants granted | 1,223,509 | 0.20 | 117,027 |
| Outstanding September 30, 2012 | 32,133,969 | $ 0.40 | $ 3,340,222 |

## 5. Earnings per share

The calculation of basic earnings per share for the three months ended September 30, 2012 was based on a weighted average number of common shares outstanding of 139,269,699 (2011: 118,630,466). For the nine months ended September 30, 2012 the calculation was based on a weighted average number of common shares outstanding of 125,935,128 (2011: 118,623,037).

### Loss attributable to common shareholders

| | For the three months ended September 30 | | For the nine months ended September 30 | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Loss attributable to common shareholders | $ 133,102 | $ 1,576,944 | $ 4,262,307 | $ 4,459,677 |
| Basic and diluted loss per share | $ 0.00 | $ 0.01 | $ 0.03 | $ 0.04 |

## 6. Operating segments

The Company has one operating segment. 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 | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| North America | $ 883,773 | $ 484,906 | $ 2,359,434 | $ 1,609,081 |
| South / Central America | 180,148 | 129,932 | 384,989 | 399,898 |
| Africa / Middle East | 325,711 | 673,162 | 912,549 | 1,374,366 |
| Europe | 8,088 | 48,369 | 137,212 | 130,018 |
| Australasia | 157,658 | 97,862 | 385,479 | 335,011 |
| Asia | (5,617) | 5,964 | 69,742 | 14,184 |
| Total | $ 1,549,761 | $ 1,440,195 | $ 4,249,405 | $ 3,862,558 |

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

Revenues from the three largest customers represent approximately 23.5% of the Company's total revenues for the three months ended September 30, 2012 (2011: 41.7%), and 22.7% for the nine months ended September 30, 2012 (2011: 26.2%).

# 7. Contingencies

a. The Company took action against Sierra Nevada Corporation ("SNC") and is defending itself against an action by SNC related to the development of the AFIRS 228. The Company has accrued a liability of $1,766,729, which represents the total amount of invoices received from SNC. The Company maintains that the claims are without merit and that the services invoiced were not provided. Management intends to vigorously defend the matter and believes the outcome will be in its favour.

   In November 2011, the Company formally notified SNC that they were in material breach of the License and Manufacturing Agreement that was entered into between the two parties on December 28, 2008. The Company demanded payment of $1,329,976 USD and $2,650,000 CDN and terminated the agreement.

   As well, the Company applied to the Alberta courts for arbitration under the provisions of the agreement. The courts granted the request for arbitration on November 29, 2011. Subsequent to the grant, SNC refused to recognize the jurisdiction of the court and has contested the cancellation of the agreement and the arbitration.

   In November 2011, SNC filed an action in Utah alleging that FLYHT failed to pay $2,042,000 USD.

   Based on legal advice and the accrual of the total amounts of invoices presented to the Company to date by SNC, management does not expect the outcome to have a material effect on the Company's financial position.

b. A final settlement was reached with a Toronto-based company as full and final settlement of the outstanding claims and counterclaims that was commenced in September 2007 alleging the Company induced a breach of contract and interfered with economic relationships. The parties agreed to dismiss existing litigation on a without cost basis with no admissions of liability. Therefore, there were no amounts to be recorded.

# 8. Related parties

(a) The Company had transactions with a company owned by a director to supply consulting services and travel expenses. The related party provides business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company.
(b) The Company also engaged in transactions with a company owned by another director to supply consulting services. The related party provides business development services such as market analysis and corporate introductions related to the commercial aviation initiatives of the Company.

| | **Included in contract labour:** | | | | **Included in accounts payable and accrued liabilities:** | |
|---|---|---|---|---|---|---|
| | **For the three months ended September 30** | | **For the nine months ended September 30** | | **September 30** | |
| | **2012** | **2011** | **2012** | **2011** | **2012** | **2011** |
| (a) | $ 22,335 | $ 22,145 | $ 67,481 | $ 65,962 | $ 14,807 | $ 14,984 |
| (b) | - | 18,780 | 17,984 | 25,377 | - | 13,777 |
| Total | $ 22,335 | $ 40,925 | $ 85,465 | $ 91,339 | $ 14,807 | $ 28,761 |

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.

# CORPORATE INFORMATION

## Registrar and Transfer Agent

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

## Share Listing

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

## Investor Relations

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

The Howard Group Inc.
Dave Burwell
Email: dave@howardgroupinc.com
Telephone: 1-403-410-7907
www.howardgroupinc.com

## Directors

| | |
|---|---|
| Bill Tempany | President & CEO, FLYHT Aerospace Solutions Ltd. |
| Richard Hayden | Director, FLYHT Aerospace Solutions Ltd. |
| Doug Marlin | Chairman, FLYHT Aerospace Solutions Ltd. & President, Marlin Ventures Ltd. |
| Mike Brown | Partner, Geselbracht Brown |
| Paul Takalo, CA | Vice-President, Standen's Limited |
| Jacques Kavafian | Vice President, Toll Cross Securities Inc. |
| Jack Olcott | President, General Aviation Company |

## Officers

| | |
|---|---|
| Bill Tempany | President & CEO |
| Thomas French, CGA | VP Finance and CFO |
| Matt Bradley | VP Business Development |
| Jeff Brunner | VP Operations |

## Auditor

KPMG LLP — Calgary, Alberta

## Legal Counsel

Chris Croteau — Tingle Merrett LLP

## Head Office

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