# SECOND QUARTER 2012

FLYHT AEROSPACE SOLUTIONS LTD.

# TABLE OF CONTENTS

# LETTER TO SHAREHOLDERS

Welcome to the first official quarterly report from FLYHT. At this year's AGM, shareholders approved the name change from AeroMechanical Services Ltd. to FLYHT Aerospace Solutions Ltd. The change was made to align our corporate image with our marketing and industry image.

We are pleased to share our second quarter results with you. The receipt of the first of many Automated Flight Information Reporting System ("AFIRS") 228 Supplemental Type Certificates ("STC") in the first quarter allowed our customers to start flying with the product and receive the value from its services in this quarter. The first release of the box has performed as anticipated. We have made software and hardware modifications to fix minor issues that have arisen and identified other minor changes in the hardware design. These changes will be incorporated in future releases of the hardware to improve performance and reliability and give us a solid platform for the safety services version of the box due out later this year, with certification slated for completion in early 2013.

There were exciting developments in the second quarter from a sales perspective. Cash was received for the first shipments to NetJets Europe, who will install AFIRS 228 on its entire fleet of 30 Hawker Beechcraft. Additionally in the quarter, the contract was completed with L-3 Aviation Recorders for the provision of AFIRS to a major OEM. This was a major step forward for FLYHT's Commercial Aviation group and we have been working with L-3 on contacts with operators of A320 aircraft that can now be fitted at the factory with AFIRS 228 products. The Company believes that the carriers currently using A320 platforms are good prospects for an AFIRS 228 retrofit and our current STC for the AFIRS 220 will be modified to enable this effort.

The contracts listed above, among others, helped grow our revenues from the same quarter in 2011 by 21.8%. The MD&A provides an explanation on revenue recognition and payments received for kits, which clearly demonstrate the growth year over year. As the AFIRS 228 matures, we expect to have continued growth in revenue.

Our inventory has increased and we are pleased to report that those increases are mainly attributable to the acquisition of parts and supplies to build AFIRS 228 products, which are already committed for installation from sales closed this year and earlier. The increase in expenses in the quarter is mainly due to the delay in Scientific Research and Experimental Development ("SRED") funds, which were received in the second quarter of 2011 and reduced our prior year research and development costs, but not yet approved for 2012. Limiting costs are the focus going forward as we reduce our dependence on outside support for 228 development. There will be ongoing costs associated with consultants for sales, customer support and legal work, but the consultants for product development will be phased out completely by the end of Q3.

The Company completed a $4.15 million private placement shortly after the end of the quarter, which provides the capital required for success in this and following years. Two thirds of the raise is included in this quarter's financial statements (with the remainder of the private placement closed on July 4). The majority of the placement was filled by existing shareholders, as well as Company management and such support continues to make this Company the innovator it is.

We are working hard to build on the success from the past two quarters. We want to thank shareholders for their continued support of the Company and assure you that we are focused on the long-term success of our organization.

Bill Tempany, President and Chief Executive Officer

# MANAGEMENT DISCUSSION & ANALYSIS

This management discussion and analysis ("MD&A") is as of August 8, 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 six months ended June 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 June 30, 2012 condensed consolidated interim financial statements in accordance with International Financial Reporting Standards ("IFRS" or "GAAP") and 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 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™ 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 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. FLYHT offers global satellite coverage, providing service to whoever needs it, when they need it, anywhere on the planet. FLYHTStream and the FLYHT Fuel Management System are software programs enabled by the AFIRS hardware.

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.

In the fourth quarter of 2011, the Company completed the first installation of its next generation product, the AFIRS 228B on a customer's aircraft. 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. The development of the next version, the 228S, is continuing with the goal of certification in the next few quarters. 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

For the first time in the aviation industry, FLYHT developed and has patent-pending technology to stream aircraft data in real time. If an aircraft encounters an emergency, FLYHT'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. 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

In the second quarter of 2012, the commercial aviation industry experienced small growth, but mostly leveled off in all three months. The Revenue Passenger Kilometers (“RPK”) of combined domestic and international travel grew 6.1% in April over the same month in 2011.[1] May RPK also increased 4.5% over the same month the previous year, though there wasn’t much change from April to May.[2] Similarly in June, there was a 6.2 % growth over the same month in 2011, though there has been a slowdown since the beginning of 2012.[3]

[1] http://www.iata.org/pressroom/pr/Pages/2012-05-30-01.aspx
[2] http://www.iata.org/pressroom/pr/Pages/2012-07-02-01.aspx
[3] http://www.iata.org/pressroom/pr/Pages/2012-08-02-01.aspx

The International Air Transport Association ("IATA") notes that Freight Tonne Kilometers ("FTK") are just slightly above the low reached during the fourth quarter of 2011. FTK numbers have fluctuated monthly, but have not made significant improvements.

The Middle East is a region that led the quarter's growth in RPK and FTK as the region experienced increased demand. FLYHT has agents in the Middle East and will continue to introduce AFIRS capabilities to airlines in the region.

IATA notes that the airline industry is still fragile due to uncertainties over the price of oil and the European economy. Due to these and other market conditions, the airline industry's profit margins are very thin. They expand in their June results with a comment that it is difficult to predict a strong trend, either positive or negative at the global level.

FLYHT received customer payment for 26 installation kits in the second quarter of 2012 compared to four in the second quarter of 2011. In addition, revenue was recognized for 12 installation kits in the second 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 second quarter of 2012 versus the same quarter of 2011 had a positive impact on the Company's revenue and income. 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.

## Contracts and Achievements of Q2 2012

FLYHT Aerospace Solutions Ltd. signed three contracts in the second quarter of 2012.

On April 5, 2012, the Company signed a contract with a Canadian charter airline for the AFIRS 228B on two Boeing 737-700 aircraft. The customer is FLYHT's ninth Canadian customer.

On April 20, 2012, the Company signed a contract with the Nigerian Civil Aviation Authority to provide a Safety Management System Dashboard as an enhancement to the flight following system the Company installed in Lagos in April 2011.

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, FLYHT received approval from the Toronto Stock Exchange to trade under the new symbol FLY.

On May 22, 2012, FLYHT announced an agreement with L-3 Aviation Recorders ("L-3 AR") to sell, certify, produce and support FLYHT's AFIRS SatCom solution to L-3 AR customers for installation on new aircraft.

On May 25, 2012, FLYHT announced an agreement with Toll Cross Securities to offer share units for sale as part of a private placement.

June 22, 2012, First tranche of the private placement closed at a price of $0.20 per Unit for proceeds of $1,838,300.

June 27, 2012, Second tranche of the private placement closed at a price of $0.20 per Unit for proceeds of $ 575,000.

June 29, 2012, Third tranche of the private placement closed at a price of $0.20 per Unit for proceeds of $755,640.

**Subsequent to the end of the quarter the final tranche of the private placement closed on July 4 at $0.20 per Unit for proceeds of $981,000. The total amount raised during the private placement was $4,149,940.

# RESULTS OF OPERATIONS – THREE AND SIX MONTHS ENDED JUNE 30, 2012

## Quarterly Results

| | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 |
|---|---|---|---|---|
| AFIRS UpTime sales | $ 581,290 | $ 264,148 | $ 714,476 | $ 369,604 |
| AFIRS UpTime usage | 756,705 | 760,392 | 756,554 | 734,964 |
| Parts | 19,168 | 49,523 | 90,659 | 5,829 |
| Services | 227,312 | 41,106 | 42,952 | 329,798 |
| Revenue | 1,584,475 | 1,115,169 | 1,604,641 | 1,440,195 |
| | | | | |
| Loss | 1,954,303 | 2,174,901 | 2,083,371 | 1,576,944 |
| Loss (before R&D) | 1,183,274 | 961,742 | 1,213,147 | 458,777 |
| Loss per share (basic & fully diluted) | $ 0.02 | $ 0.02 | $ 0.02 | $ 0.01 |

| | Q2 2011 | Q1 2011 | Q4 2010 | Q3 2010 |
|---|---|---|---|---|
| AFIRS UpTime sales | $ 377,607 | $ 262,655 | $ 287,589 | $ 226,187 |
| AFIRS UpTime usage | 740,471 | 719,773 | 705,366 | 674,572 |
| Parts | 62,849 | 41,871 | 38,240 | 43,712 |
| Services | 119,984 | 97,153 | 389,850 | 65,496 |
| Revenue | 1,300,911 | 1,121,452 | 1,421,045 | 1,009,967 |
| | | | | |
| Loss | 1,397,442 | 1,485,292 | 1,753,251 | 2,601,005 |
| Loss (before R&D) | 841,827 | 702,805 | 210,917 | 855,723 |
| Loss per share (basic & fully diluted) | $ 0.01 | $ 0.01 | $ 0.02 | $ 0.03 |

## Liquidity and Capital Resource

The Company's cash at June 30, 2012 decreased to $1,160,526 from $1,928,065 at December 31, 2011. The Company has an available operating line of $250,000 that was undrawn at June 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 June 30, 2012, the Company had negative working capital of $3,818,629 compared to negative $2,947,863 as of December 31, 2011, a decrease of $870,766. 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 June 30, 2012 would be negative $213,627 compared to negative $327,224 at December 31, 2011.

| | June 30, 2012 | December 31, 2011 | Variance |
|---|---|---|---|
| Cash and cash equivalents | $ 1,160,526 | $ 1,928,065 | $ (767,539) |
| Cash held in escrow | 880,000 | - | 880,000 |
| Restricted cash | 250,000 | 250,000 | - |
| Trade and other receivables | 887,508 | 680,886 | 206,622 |
| Deposits and prepaid expenses | 166,494 | 199,076 | (32,582) |
| Inventory | 1,227,516 | 975,298 | 252,218 |
| Trade payables and accrued liabilities | (5,883,223) | (4,903,537) | (979,686) |
| Unearned revenue | (2,104,570) | (1,639,684) | (464,886) |
| Loans and borrowings | (382,373) | (384,815) | 2,442 |
| Finance lease obligations | (18,624) | (48,715) | 30,091 |
| Provisions | (1,883) | (4,437) | 2,554 |
| **Working capital** | **$ (3,818,629)** | **$ (2,947,863)** | **$ (870,766)** |
| | | | |
| **Modified working capital** | **$ (213,627)** | **$ (327,224)** | **$ (113,598)** |

As of June 30, 2012, the Canadian equivalent of the Company's outstanding accounts payable to Sierra Nevada Corporation ("SNC") was $1,841,218 (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 $1,977,411 at June 30, 2012 and negative $1,115,898 at December 31, 2011. As well, the modified working capital would be a positive $1,627,591 at June 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 second 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 will has begun to meet the timelines required by our current customers and prospects. The current accounts payable amount outstanding of $1,841,218 is presently under dispute in the courts. See the Contingency section on page 19 for further clarification.

During the second quarter of 2012 the Company issued 15,844,700 share units pursuant to a combination of brokered and non-brokered private placements at $0.20 per share unit resulting in gross proceeds of $3,168,940. 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 June 30, 2012 share purchase warrants outstanding totaled 7,922,350. 4,595,750 will expire June 22, 2014; 1,437,500, June 27, 2014;

and 1,889,100, June 29, 2014. The net cash proceeds after issuance costs of the brokered and non-brokered private placements totaled $2,906,836. A further 880,159 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; and 264,474, June 29, 2014.

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 August 8, 2012, FLYHT's issued and outstanding share capital was 139,386,166.

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 approximately 45 days 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 second quarter. Payment was received for 26 installation kits in the second quarter of 2012, compared to four in the second quarter of 2011, bringing 2012 year-to-date (“YTD”) total payments for installation kits to 43, compared to 10 in 2011.

| | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Opening balance | $ 1,373,504 | $ 580,785 | $ 792,719 | $ 980,955 | $ 527,457 | $ 453,498 |
| Payments received from customers | 1,119,062 | 502,192 | 616,870 | 1,813,584 | 783,494 | 1,030,090 |
| Moved to unearned revenue | (992,134) | (102,022) | (890,112) | (1,294,107) | (329,996) | (964,111) |
| **Balance, June 30** | **$ 1,500,432** | **$ 980,955** | **$ 519,477** | **$ 1,500,432** | **$ 980,955** | **$ 519,477** |

## Unearned revenue

The chart below outlines the movement in the Company’s unearned revenue throughout the second quarter. Revenue was recognized for 12 installation kits in 2012’s second quarter compared to nine in the second quarter of 2011. YTD, revenue has been recognized for 19 installation kits, as compared to 15 in the same period of 2011.

| | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Opening balance | $ 1,918,144 | $ 2,701,908 | $ (783,764) | $ 1,897,204 | $ 2,831,878 | $ (934,674) |
| AFIRS UpTime sales: shipped, not accepted | 992,134 | 102,022 | 890,112 | 1,294,107 | 329,996 | 964,111 |
| AFIRS UpTime usage: prepaid | 159,204 | 24,461 | 134,743 | 248,791 | 48,816 | 199,975 |
| AFIRS UpTime sales: revenue recognized | (581,290) | (377,607) | (203,683) | (845,438) | (663,807) | (181,631) |
| AFIRS UpTime usage: revenue recognized | (190,482) | (29,347) | (161,135) | (232,574) | (61,066) | (171,508) |
| License fees: revenue recognized | (64,380) | (64,380) | - | (128,760) | (128,760) | - |
| **Balance, June 30** | **$ 2,233,330** | **$ 2,357,057** | **$ (123,727)** | **$ 2,233,330** | **$ 2,357,057** | **$ (123,727)** |

# 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 21.8% from $1,300,911 in the second quarter of 2011 to $1,584,475 in the same period of 2012. AFIRS Uptime sales increased by 53.9%, AFIRS Uptime usage increased by 2.2% and Services revenue increased by 89.5%. These were offset by a decrease in Parts sales of 69.5%.

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 June 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

| | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| AFIRS UpTime sales | $ 581,290 | $ 377,607 | $ 203,683 | $ 845,438 | $ 640,262 | $ 205,176 |
| AFIRS UpTime usage | 756,705 | 740,471 | 16,234 | 1,517,097 | 1,460,244 | 56,853 |
| Parts | 19,168 | 62,849 | (43,681) | 68,692 | 104,720 | (36,028) |
| Services | 227,312 | 119,984 | 107,328 | 268,417 | 217,137 | 51,280 |
| **Total** | **$ 1,584,475** | **$ 1,300,911** | **$ 283,564** | **$ 2,699,644** | **$ 2,422,363** | **$ 277,281** |

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 47.8% of the Company's revenue in the second quarter of 2012 was recurring, compared to 56.9% in the second quarter of 2011. The decrease in percentage is mainly due to a large increase in Services revenue, and not due to a decrease in AFIRS Uptime usage. 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.

| | Q2 2012 | Q2 2011 | YTD 2012 | YTD 2011 |
|---|---|---|---|---|
| North America | $ 878,202 | $ 573,680 | $ 1,475,661 | $ 1,124,175 |
| South/Central America | 101,009 | 132,763 | 204,841 | 269,966 |
| Africa/Middle East | 388,740 | 390,609 | 586,838 | 701,205 |
| Europe | 16,976 | 66,294 | 129,123 | 81,648 |
| Australasia | 130,193 | 132,581 | 227,821 | 237,149 |
| Asia | 69,355 | 4,984 | 75,360 | 8,220 |
| **Total** | **$ 1,584,475** | **$ 1,300,911** | **$ 2,699,644** | **$ 2,422,363** |

| | Percent Q2 2012 | Percent Q2 2011 | Percent YTD 2012 | Percent YTD 2011 |
|---|---|---|---|---|
| North America | 55.4% | 44.1% | 54.7% | 46.4% |
| South/Central America | 6.4% | 10.2% | 7.6% | 11.1% |
| Africa/Middle East | 24.5% | 30.0% | 21.7% | 28.9% |
| Europe | 1.1% | 5.1% | 4.8% | 3.4% |
| Australasia | 8.2% | 10.2% | 8.4% | 9.8% |
| Asia | 4.4% | .4% | 2.8% | .3% |
| **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 second quarter of 2012 was 56.3% compared to 40.2% in 2011's second quarter. The increase was due to a difference in the mix of revenue sources, with an increase in the second quarter of 2012 of AFIRS Uptime sales revenue which has lower margins than other revenue types. 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 |
|---|---|
| Q2 2012 | 43.7% |
| Q1 2012 | 54.8% |
| Q4 2011 | 40.2% |
| Q3 2011 | 62.7% |
| Q2 2011 | 59.8% |
| Q1 2011 | 56.0% |
| Q4 2010 | 66.7% |
| Q3 2010 | 50.4% |

## 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 | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 437,776 | $ 384,726 | $ 53,050 | $ 914,482 | $ 849,079 | $ 65,403 |
| Share based compensation | 104,598 | 83,733 | 20,865 | 120,071 | 83,733 | 36,338 |
| Contract labour | 142,671 | 216,660 | (73,989) | 322,514 | 366,414 | (43,900) |
| Office | 86,171 | 77,884 | 8,287 | 185,174 | 154,475 | 30,699 |
| Travel | 81,568 | 32,672 | 48,896 | 184,713 | 85,968 | 98,745 |
| Equipment & maintenance | 6,725 | 14,283 | (7,558) | 13,745 | 39,641 | (25,896) |
| Depreciation | 13,157 | - | 13,157 | 26,438 | - | 26,438 |
| Marketing | 25,547 | 29,579 | (4,032) | 41,862 | 35,808 | 6,054 |
| Other | 4,544 | - | 4,544 | 62,726 | (7,709) | 70,435 |
| **Total** | **$ 902,757** | **$ 839,537** | **$ 63,220** | **$ 1,871,725** | **$ 1,607,409** | **$ 264,316** |

**Salaries and benefits** increased throughout the second quarter ended June 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. A portion of the resulting increase was also allocated to R&D expenses as the increased staff was engaged in developing the AFIRS 228.

**Share based compensation** increased in the quarter and YTD due to higher level of option grants to an increased base of distribution-related staff 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 one staff member in the fourth quarter of 2011.

**Contract labour** decreased in both the second quarter ended June 30, 2012 and YTD, compared with the same periods last year. There has been a reduced need for developing collateral specifically related to the rebranding of the FLYHT logo and a reduction in contractors supplying distribution related services.

**Office** expenses increased in the quarter and YTD due to several factors, including YTD increases of $8,319 in postage and courier costs as the result of a new marketing campaign, $6,584 in training expenses, $4,342 in additional membership fees for industry groups that FLYHT has become involved with, $2,100 for income tax consulting relating to FLYHT Inc, and an increased rent allocation of $14,767. Offsetting these YTD increases was a decreased allocation of communication service costs. Quarterly differences were due to a $1,515 increase in postage and courier costs, $3,792 in training expenses, $962 in membership fees, and an increased rent allocation of $9,355. The allocation differences do not represent a change in FLYHT's overall expense.

**Travel** expenses increased largely as the result of increased travel and meals associated with sales activities including trade show attendance.

**Equipment and maintenance** decreases 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.

**Depreciation** expense increased in the quarter and YTD due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $15,232 and quarter to date by $8,581 due to a decrease in the need to acquire capital equipment.

**Marketing** expenses decreased in the quarter while increasing YTD, due to an increased presence at tradeshows in the first quarter of 2012 and the resulting requirement for marketing collateral that did not carry through to the second quarter of 2012.

**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 second quarter, a partial recovery of the first quarter allowance offset an additional allowance of $6,457 for one customer in the second quarter that appears to be in financial difficulty.

## 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 | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 302,088 | $ 263,591 | $ 38,497 | $ 634,597 | $ 566,445 | $ 68,152 |
| Share based compensation | 207,858 | 147,339 | 60,519 | 207,858 | 147,997 | 59,861 |
| Contract labour | 17,729 | 16,978 | 751 | 31,749 | 47,343 | (15,594) |
| Office | 80,013 | 81,971 | (1,958) | 164,592 | 163,841 | 751 |
| Legal fees | 57,993 | 41,808 | 16,185 | 103,958 | 43,444 | 60,514 |
| Audit and accounting | 33,305 | 41,269 | (7,964) | 58,305 | 77,383 | (19,078) |
| Investor relations | 27,900 | 49,135 | (21,235) | 38,816 | 75,863 | (37,047) |
| Brokerage, stock exchange, and transfer agent fees | 12,620 | 14,269 | (1,649) | 21,782 | 26,203 | (4,421) |
| Travel | 28,238 | 21,457 | 6,781 | 45,533 | 40,313 | 5,220 |
| Equipment and maintenance | 14,513 | 12,183 | 2,330 | 27,096 | 24,103 | 2,993 |
| Depreciation | 7,026 | 34,631 | (27,605) | 14,417 | 67,270 | (52,853) |
| Other | 2,605 | 2,948 | (343) | 5,624 | 7,393 | (1,769) |
| **Total** | **$ 791,888** | **$ 727,579** | **$ 64,309** | **$1,354,327** | **$1,287,598** | **$ 66,729** |

**Salaries and benefits** increased throughout the second quarter and the YTD period ended June 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 higher level of option grants combined with an increase in the calculated fair value per share.

**Contract labour** decreased 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** remained relatively steady in the second quarter, but decreased YTD. The YTD changes were a combination of a $7,458 increase in communication service costs, and an increase in insurance premiums of $7,786 due to increased coverage limits. Offsetting these increases was a decrease in office supplies expenses of $4,167 along with a decrease in rent expense of $7,123, which was due to an allocation among cost centres, and not a decrease of the overall rent expense to FLYHT.

**Legal fees** increased both in the quarter and 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. The increase in the quarter was also partially due to legal services required for closure of legal proceedings (see Contingency (b) on page 19 for more detail).

**Audit and accounting** expense decreases are 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 to obtain better shareholder value.

**Brokerage, stock exchange, and transfer agent fees** decreased due to reduced stock exchange fees in 2012.

**Travel** expenses increased in the quarter and YTD as a result of travel related to operations staff attendance at industry conferences and meetings.

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

**Depreciation** expense decreased in the quarter and YTD partially due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $15,232 and quarter to date by $8,581 due to a decrease in the need to acquire capital equipment.

## Research and development expenses

| Major Category | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Salaries and benefits | $ 466,155 | $ 335,128 | $ 131,027 | $ 861,019 | $ 532,561 | $ 328,458 |
| Share based compensation | 12,615 | 6,780 | 5,835 | 12,615 | 6,780 | 5,835 |
| Contract labour | 301,880 | 533,514 | (231,634) | 912,406 | 1,166,931 | (254,525) |
| Office | 83,206 | 11,058 | 72,148 | 236,268 | 23,169 | 213,099 |
| Travel | 20,089 | 12,204 | 7,885 | 26,096 | 34,406 | (8,310) |
| Equipment & maintenance | 12,134 | 3,304 | 8,830 | 23,938 | 4,980 | 18,958 |
| Components | (130,917) | 7,998 | (138,915) | (35,200) | 13,617 | (48,817) |
| Government grants | - | - | - | (64,137) | (90,031) | 25,894 |
| SRED credit | - | (355,982) | 355,982 | - | (355,982) | 355,982 |
| Depreciation | 5,867 | - | 5,867 | 11,183 | - | 11,183 |
| Other | - | 1,611 | (1,611) | - | 1,671 | (1,671) |
| **Total** | **$ 771,029** | **$ 555,615** | **$ 215,414** | **$ 1,984,188** | **$ 1,338,102** | **$ 646,086** |

**Salaries and benefits** increased throughout the second quarter ended June 30, 2012 compared with the same period last year. This was also the case for the YTD numbers, as Company staff was utilized to replace SNC and other contractors throughout the later portion of 2011 and 2012.

**Share based compensation** increased in the quarter and 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.

**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 increased in the quarter due to increased travel related to flight tests required to obtain STC's. The YTD decrease is due to bringing the AFIRS 228 in-house and the resulting reduction in need to travel to contractor sites.

**Equipment and maintenance** increases are due to the 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 were no longer required for development but would be used in the production of units for customers.

**Government grants** decrease YTD is due to differences in funding received in 2011 versus 2012. The $64,137 in 2012 is the portion of the funds received that has been accounted for as a grant from the Strategic Aerospace and Defence Initiative ("SADI") grant, while the $90,031 in 2011 was received from the Industrial Research Assistance Program ("IRAP") program.

**SRED credit** differences between the quarter and YTD periods of 2011 and 2012 is the result of a timing difference. Funds for the 2010 SRED credit were received in 2011, while any credit to be received in 2012 will be later in the year. Timing of receipt of these funds is dependent on when the Canada Revenue Agency completes their assessment.

**Depreciation** expenses increased in the quarter and YTD due to an allocation between cost centers. FLYHT's total depreciation decreased YTD by $15,232 and quarter to date by $8,581 due to a decrease in the need to acquire capital equipment.

## 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.

| Major Category | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Interest income | $ - | $ 6,805 | $ (6,805) | $ 72 | $ 18,329 | $ (18,257) |
| Net foreign exchange gain | - | - | - | - | 36,396 | (36,396) |
| Bank service charges | 4,691 | 4,308 | 383 | 10,441 | 10,051 | 390 |
| Interest expense | 4,480 | 1,236 | 3,244 | 6,895 | 2,963 | 3,932 |
| Government grant accretion | 12,799 | - | 12,799 | 24,053 | - | 24,053 |
| Debenture interest | 97,787 | 92,858 | 4,929 | 193,828 | 181,579 | 12,249 |
| Debenture cost amortization | 19,529 | 19,529 | - | 39,058 | 38,844 | 214 |
| Net foreign exchange loss | 104,408 | 448 | 103,960 | 75,743 | - | 75,743 |
| **Net finance income** | **$ (243,694)** | **$ (111,574)** | **$ (132,120)** | **$ (349,946)** | **$ (178,712)** | **$ (171,234)** |

**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** occurred in the first quarter of 2011 due to the relative strength of the Canadian dollar in relation to the U.S. dollar which did not occur in 2012 due to a weakening of the Canadian dollar in relation to the U.S. dollar.

**Interest expense** increased in the quarter due to interest owing on a short-term loan. The YTD increase is also due to an increase in equipment leased.

**Government grant interest** is the recognition of the interest component of the SADI grant which did not occur in 2011.

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

**Net foreign exchange losses** occurred in the second quarters of both 2011 and 2012, although more so in 2012, due to the weakening of the Canadian dollar in relation to the U.S. dollar.

## Net loss

| Major Category | Q2 2012 | Q2 2011 | Variance | YTD 2012 | YTD 2011 | Variance |
|---|---|---|---|---|---|---|
| Net loss | $ 1,954,303 | $ 1,397,442 | $ 556,861 | $ 4,129,204 | $ 2,882,734 | $ 1,246,470 |
| Net loss without R&D | $ 1,183,274 | $ 841,827 | $ 341,447 | $ 2,145,016 | $ 1,544,632 | $ 600,3784 |

## 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 Q2 2012, over 98% of the Company's gross sales were made in U.S. dollars, unchanged from the second 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 second quarter of 2012, the Company's transactions with a company owned by a director to supply consulting services and travel expenses totaled $22,735, compared to $21,698 in the second 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 second quarter, the Company did not engage in transactions with a company owned by another director to supply consulting services that had been used in 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.

| | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Related party (a) | $ 22,735 | $ 21,698 | $ 45,146 | $ 43,818 |
| Related party (b) | - | 5,866 | 17,984 | 5,866 |
| **Total** | **$ 22,735** | **$ 27,564** | **$ 63,130** | **$ 49,684** |

Amounts included in accounts payable and accrued liabilities:

| | June 30 | |
|---|---|---|
| | **2012** | **2011** |
| Related party (a) | $ 23,058 | $ 7,324 |
| Related party (b) | 12,298 | 6,589 |
| **Total** | **$ 35,356** | **$ 13,913** |

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.

## Contractual Obligations

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

| June 30, 2012 | < 2 months | 2-12 months | 1-2 years | 2-5 years | > 5 years | Total |
|---|---|---|---|---|---|---|
| Accounts payable | $ 1,439,715 | $ 3,881 | $ - | * $ 1,841,218 | $ - | $ 3,284,814 |
| Compensation and statutory deductions | 441,919 | 218,344 | - | - | - | 660,263 |
| Finance lease liabilities | 4,432 | 20,291 | 23,291 | 2,913 | - | 50,927 |
| Accrued liabilities | 225,498 | 113,382 | - | - | - | 338,880 |
| Loans and borrowings | 13,094 | 374,762 | 261,682 | 3,530,183 | 199,067 | 4,378,788 |
| **Total** | **$ 2,124,658** | **$ 730,660** | **$ 284,973** | **$ 5,374,314** | **$ 199,067** | **$ 8,713,672** |

* 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 June 30, 2012 was $116,024 compared to $166,526 at June 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 June 30, 2012, compared to $47,186 at June 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 June 30, 2012, an outstanding repayable balance of $983,753. 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 second quarter of 2012, FLYHT did not enter into any new lease agreements. FLYHT entered into one new lease in the second quarter of 2011 to cover the purchase of new computer equipment. Minimum lease payments are as follows for existing capital leases:

| Year | Total |
|---|---|
| 2012 | $ 12,549 |
| 2013 | 24,350 |
| 2014 | 14,028 |
| **Total** | **$ 50,927** |

The imputed interest included in the payments is $8,700 (2011 - $9,984) leaving a total obligation of $42,227 (2011 - $101,451).

## 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 $1,841,218, 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 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.

## Subsequent Events

On July 4, 2012 the Company issued 4,905,000 units at $0.20 per unit in connection with the final tranche of a non-brokered private placement with each unit consisting of one common share and one-half of one common share purchase warrant for net cash proceeds of $912,330. In connection with this non-brokered private placement 2,452,500 warrants were issued entitling the holder to acquire one common share of the Company at $0.30 until July 4, 2014. As well, 343,350 agent warrants were issued entitling the holder to acquire one common share of the Company at $0.20 until July 4, 2014. Blumont Capital Corp. subscribed for $75,000 worth of units, as approval is pending for their 11.03% of control, directly or indirectly, by the Toronto Stock Exchange the proceeds has been placed in escrow.

## 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 six month periods ended June 30, 2012 and June 30, 2011.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (unaudited)

| | | June 30, 2012 | | December 31, 2011 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | $ | 1,160,526 | $ | 1,928,065 |
| Cash held in escrow (note 4) | | 880,000 | | - |
| Restricted cash | | 250,000 | | 250,000 |
| Trade and other receivables | | 887,508 | | 680,886 |
| Deposits and prepaid expenses | | 166,494 | | 199,076 |
| Inventory | | 1,227,516 | | 975,298 |
| **Total current assets** | | 4,572,044 | | 4,033,325 |
| **Non-current assets** | | | | |
| Property and equipment | | 289,778 | | 336,660 |
| Rental assets | | 46,723 | | 127,867 |
| Intangible assets | | 131,920 | | 201,217 |
| Inventory | | 1,107,251 | | 810,640 |
| **Total non-current assets** | | 1,575,672 | | 1,476,384 |
| **Total assets** | $ | 6,147,716 | $ | 5,509,709 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Trade payables and accrued liabilities | $ | 5,883,223 | $ | 4,903,537 |
| Unearned revenue | | 2,104,570 | | 1,639,684 |
| Loans and borrowings | | 382,373 | | 384,815 |
| Finance lease obligations | | 18,624 | | 48,715 |
| Provisions | | 1,883 | | 4,437 |
| **Total current liabilities** | | 8,390,673 | | 6,981,188 |
| **Non-current liabilities** | | | | |
| Unearned revenue | | 128,760 | | 257,520 |
| Loans and borrowings | | 2,736,656 | | 2,486,199 |
| Finance lease obligations | | 23,604 | | 33,138 |
| Provisions | | 43,709 | | 47,027 |
| **Total non-current liabilities** | | 2,932,729 | | 2,823,884 |
| **Total liabilities** | | 11,323,402 | | 9,805,072 |
| **Equity (deficiency)** | | | | |
| Share capital (note 5) | | 39,040,205 | | 36,741,492 |
| Convertible debenture – equity feature | | 231,318 | | 231,318 |
| Warrants (note 5) | | 3,110,080 | | 2,499,778 |
| Contributed surplus | | 6,962,472 | | 6,622,606 |
| Accumulated other comprehensive income (loss) | | - | | - |
| Deficit | | (54,519,761) | | (50,390,557) |
| **Total equity (deficiency)** | | (5,175,686) | | (4,295,363) |
| **Total liabilities and equity (deficiency)** | $ | 6,147,716 | $ | 5,509,709 |

See accompanying notes to condensed consolidated interim financial statements.
Going concern (note 2e)
Contingencies (note 8)

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

| | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Revenue (note 7) | $ 1,584,475 | $ 1,300,911 | $ 2,699,644 | $ 2,422,363 |
| Cost of sales | 892,218 | 522,547 | 1,395,850 | 1,016,155 |
| **Gross profit** | 692,257 | 778,364 | 1,303,794 | 1,406,208 |
| Other income | 64,380 | 64,380 | 128,760 | 128,760 |
| Distribution expenses | 902,757 | 839,537 | 1,871,725 | 1,607,409 |
| Administration expenses | 791,888 | 727,579 | 1,354,327 | 1,287,598 |
| Research and development expenses | 771,029 | 555,615 | 1,984,188 | 1,338,102 |
| **Results from operating activities** | (1,709,037) | (1,279,987) | (3,777,686) | (2,698,141) |
| Finance income | - | 6,805 | 72 | 54,725 |
| Finance costs | 243,694 | 118,379 | 350,018 | 233,437 |
| **Net finance costs** | (243,694) | (111,574) | (349,946) | (178,712) |
| **Loss for the period before income tax** | (1,952,731) | (1,391,561) | (4,127,632) | (2,876,853) |
| Income tax expense | (1,572) | (5,881) | (1,572) | (5,881) |
| **Loss for the period** | (1,954,303) | (1,397,442) | (4,129,204) | (2,882,734) |
| Foreign currency translation | (98) | 43 | - | (6) |
| **Total comprehensive loss for the period** | $ (1,954,401) | $ (1,397,399) | $ (4,129,204) | $ (2,882,740) |
| **Earnings (loss) per share** | | | | |
| Basic and diluted loss per share (note 6) | $ (0.02) | $ (0.02) | $ (0.03) | $ (0.01) |

See accompanying notes to condensed consolidated interim financial statements.

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

For the six months ended June 30, 2012 and 2011

| | Share Capital | Convertible Debenture | Warrants | Contributed Surplus | Foreign Currency Translation Reserve* | Deficit | Total Equity (Deficit) |
|---|---|---|---|---|---|---|---|
| **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 | - | - | - | - | - | (2,882,734) | (2,882,734) |
| Foreign currency translation differences | - | - | - | - | (6) | - | (6) |
| **Total comprehensive loss for the period** | - | - | - | - | (6) | (2,882,734) | (2,882,740) |
| **Contributions by and distributions to owners** | | | | | | | |
| Share issue cost recovery | 3,913 | - | - | - | - | - | 3,913 |
| Share-based payment transactions | - | - | - | 238,510 | - | - | 238,510 |
| 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) | 2,475,825 | - | - | 246,473 |
| **Balance, June 30, 2011** | $ 36,741,492 | $ 231,318 | $ 2,894,018 | $ 6,225,939 | $ (6) | $ (46,730,242) | $ (637,481) |
| **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 | - | - | - | - | - | (4,129,204) | (4,129,204) |
| Foreign currency translation differences | - | - | - | - | - | - | - |
| **Total comprehensive loss for the period** | - | - | - | - | - | (4,129,204) | (4,129,204) |
| **Contributions by and distributions to owners** | | | | | | | |
| Issue of common shares | 3,168,940 | | | | | | 3,168,940 |
| Share issue cost | (342,735) | | | | | | (342,735) |
| Bifurcation of warrants | (529,670) | | | | | | (529,670) |
| Issues of warrants | | | 610,302 | | | | 610,302 |
| Share-based payment transactions | - | - | - | 340,544 | - | - | 340,544 |
| Share options exercised | 2,178 | - | - | (678) | - | - | 1,500 |
| Total contributions by and distributions to owners | 2,298,713 | - | 610,302 | 339,866 | - | - | 3,248,881 |
| **Balance, June 30, 2012** | $ 39,040,205 | $ 231,318 | $ 3,110,080 | $ 6,962,472 | $ - | $ (54,519,761) | $ (5,175,686) |

*Accumulated other comprehensive income (loss)

See accompanying notes to condensed consolidated interim financial statements.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS (unaudited)

| | For the six months ended June 30 | | | |
|---|---|---|---|---|
| | | 2012 | | 2011 |
| **Cash flows from operating activities** | | | | |
| Loss for the period | $ | (4,129,204) | $ | (2,882,734) |
| Adjustments for: | | | | |
| Depreciation | | 52,038 | | 67,270 |
| Depreciation of rental assets | | 16,133 | | 23,544 |
| Amortization of intangible assets | | 69,297 | | 69,297 |
| Convertible debenture accretion | | 193,828 | | 181,579 |
| Amortization of debenture issue costs | | 39,058 | | 38,844 |
| Government grant accretion | | 24,054 | | - |
| Government grant | | (64,137) | | - |
| Loss on sale of rental assets | | 61,116 | | |
| Equity-settled share-based payment transactions | | 340,544 | | 238,510 |
| Change in inventories | | (548,829) | | 107,289 |
| Change in trade and other receivable | | (236,052) | | (387,784) |
| Change in deposits and prepaid expenses | | 32,582 | | (37,148) |
| Change in trade and other payables | | 965,322 | | (166,188) |
| Change in provisions | | (5,872) | | (9,312) |
| Change in unearned revenue | | 336,126 | | (474,821) |
| Unrealized foreign exchange | | 77,398 | | (41,307) |
| Interest income | | (72) | | (18,329) |
| Interest expense | | 6,895 | | 2,963 |
| **Net cash used in operating activities** | | (2,769,775) | | (3,288,327) |
| | | | | |
| **Cash flows from investing activities** | | | | |
| Acquisitions of property and equipment | | (5,155) | | (44,128) |
| Disposal (acquisitions) of rental assets | | 3,894 | | (871) |
| Interest received | | 72 | | 18,329 |
| **Net cash used in investing activities** | | (1,189) | | (26,670) |
| | | | | |
| **Cash flows from financing activities** | | | | |
| Share issue (cost) recovery | | (262,103) | | 3,913 |
| Proceeds from issue of shares and warrants | | 3,168,940 | | - |
| Proceeds from issue of shares and warrants – in escrow | | (880,000) | | - |
| Proceeds from exercise of share options and warrants | | 1,500 | | 4,050 |
| Proceeds from government grant | | 92,851 | | - |
| Repayment of loans and borrowings | | (37,639) | | (29,851) |
| Payment of finance lease liabilities | | (39,625) | | (16,696) |
| Interest paid | | (6,895) | | (2,963) |
| **Net cash from (used in) financing activities** | | 2,037,029 | | (41,547) |
| | | | | |
| **Net decrease in cash and cash equivalents** | | (733,935) | | (3,356,544) |
| Cash and cash equivalents at January 1 | | 1,928,065 | | 6,617,852 |
| Effect of exchange rate fluctuations on cash held | | (33,604) | | (15,753) |
| **Cash and cash equivalents** | $ | 1,160,526 | $ | 3,245,555 |

See accompanying notes to condensed consolidated interim financial statements.

# NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

## 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 six months ended June 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 August 8, 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. At June 30, 2012, the Company had negative working capital of $3,818,629, a deficit of $54,519,761, a net loss of $4,129,204 and negative cash flow from operations of $2,769,775.

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. Cash Held in Escrow

The Company completed a private placement on June 30, 2012 for which $880,000 was held in escrow pending the approval of the TSX. TSX approval is required for the funds received from Blumont Capital Corp. since their subscriptions for units will result in control, directly or indirectly, of in excess of 10% of all the issued and outstanding common shares of the Company.

## 5. 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.

## 5. 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 | 15,844,700 | | 3,168,940 |
| Share issue costs | | | (342,735) |
| Bifurcation of warrants | | | (529,670) |
| Exercise of employee options | 6,000 | | 1,500 |
| Contributed surplus from exercise of employee options | | | 678 |
| Balance June 30, 2012 | 134,481,166 | $ | 39,040,205 |

In three tranches on June 24, 26 and 29 2012 the Company issued a total of 15,844,700 share units at $0.20 per share unit in connection with a brokered and non-brokered private placements resulting in gross proceeds of $3,168,940. 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 June 30, 2012 share purchase warrants outstanding totaled 7,922,350. The expiry details are: 4,595,750 will expire June 22, 2014; 1,437,500, June 27, 2014; and 1,889,100, June 29, 2014. The net cash proceeds after issuance costs of the brokered and non-brokered private placements totaled $2,906,836. A further 880,159 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; and 264,474, June 29, 2014.

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.

### *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 June 30, 2012, there were 13,448,117 (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, which have not yet vested (2011:150,000). 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 June 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 | 2,132,500 | | 0.25 | 2,091,500 | | 0.25 |
| Options exercised | (6,000) | | 0.25 | (15,000) | | 0.27 |
| Outstanding, June 30 | 6,612,491 | $ | 0.27 | 4,575,477 | $ | 0.33 |
| | | | | | | |
| Exercisable, June 30 | 5,612,491 | $ | 0.28 | 4,425,477 | $ | 0.33 |

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

### *Stock option plan (continued)*

Weighted average life remaining for the options outstanding and exercisable is 2.5 years. The exercise prices for options outstanding at June 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 | 1.5 | - | 1.5 |
| $0.25 | 2,045,000 | 2.5 | 2,045,000 | 2.5 |
| $0.25 | 2,132,500 | 3.5 | 2,132,500 | 3.5 |
| $0.27 | 428,331 | 0.5 | 428,331 | 0.5 |
| $0.41 | 790,000 | 1.5 | 790,000 | 1.5 |
| $0.41 | 150,000 | 0.5 | 150,000 | 0.5 |
| $0.50 | 66,660 | 0.5 | 66,660 | 0.5 |
| Total | 6,612,491 | 2.4 | 5,612,491 | 2.5 |

The weighted average fair value of the options granted during the first two quarters of the year was $0.15 (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 | 1.41% | 1.94% |
| Expected life (years) | 3.65 | 3.58 |
| Volatility in the price of the Company's common shares | 102% | 109% |
| Dividend yield rate | 0.00% | 0.00% |

### *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 | 7,922,350 | 0.30 | 529,670 |
| Agent warrants granted | 880,159 | 0.20 | 80,632 |
| Outstanding June 30, 2012 | 29,338,119 | $ 0.41 | $ 3,110,080 |

## 6. Earnings per share

### Basic earnings per share

The calculation of basic earnings per share for the three months ended June 30, 2012 was based on a weighted average number of common shares outstanding of 119,754,926 (2011: 118,615,466). For the six months ended June 30, 2012 the calculation was based on a weighted average number of common shares outstanding of 119,194,575 (2011: 118,621,764).

### Loss attributable to common shareholders

| | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Profit (loss) attributable to common shareholders | $ (1,954,303) | $ (1,397,442) | $ (4,129,204) | $ (2,882,734) |
| Basic and diluted loss per share | $ (0.02) | $ (0.02) | $ (0.03) | $ (0.01) |

## 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 June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| North America | $ 878,202 | $ 573,680 | $ 1,475,661 | $ 1,124,175 |
| South / Central America | 101,009 | 132,763 | 204,841 | 269,966 |
| Africa / Middle East | 388,740 | 390,609 | 586,838 | 701,205 |
| Europe | 16,976 | 66,294 | 129,123 | 81,648 |
| Australasia | 130,193 | 132,581 | 227,821 | 237,149 |
| Asia | 69,355 | 4,984 | 75,360 | 8,220 |
| Total | $ 1,584,475 | $ 1,300,911 | $ 2,699,644 | $ 2,422,363 |

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

### Major customers

Revenues from the three largest customers represent approximately 41.3% of the Company’s total revenues for the three months ended June 30, 2012 (2011: 26.5%), and 25.3% for the six months ended June 30, 2012 (2011: 27.0%).

## 8. Contingency

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 $1,841,218, 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.

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.

## 9. 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.

Amounts included in contract labour:

| | For the three months ended June 30 | | For the six months ended June 30 | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Related party (a) | $ 22,735 | $ 21,698 | $ 45,146 | $ 43,818 |
| Related party (b) | - | 5,866 | 17,984 | 5,866 |
| Total | $ 22,735 | $ 27,564 | $ 63,130 | $ 49,684 |

Amounts included in accounts payable and accrued liabilities:

| | June 30 | |
|---|---|---|
| | **2012** | **2011** |
| Related party (a) | $ 23,058 | $ 7,324 |
| Related party (b) | 12,298 | 6,589 |
| Total | $ 35,356 | $ 13,913 |

## 9. Related parties (continued)

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.

## 10. Subsequent Event

On July 4, 2012 the Company issued 4,905,000 units at $0.20 per unit in connection with the final tranche of a non-brokered private placement with each unit consisting of one common share and one-half of one common share purchase warrant for net cash proceeds of $912,330. In connection with this non-brokered private placement 2,452,500 warrants were issued entitling the holder to acquire one common share of the Company at $0.30 until July 4, 2014. As well, 343,350 agent warrants were issued entitling the holder to acquire one common share of the Company at $0.20 until July 4, 2014. Blumont Capital Corp. subscribed for $75,000 worth of Units and pending approval of their 11.03% of control, directly or indirectly, by the Toronto Stock Exchange the proceeds has been placed in escrow.

# 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
Toll free: 1-866-250-9956
www.flyht.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