



# FIRST QUARTER REPORT

FLYHT AEROSPACE SOLUTIONS LTD.

2013



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# LETTER TO SHAREHOLDERS

To Our Shareholders,

Welcome to the first quarter report of FLYHT Aerospace Solutions Ltd. (the “**Company**”). We are quite excited about the growth in revenue we’ve seen this quarter. There has been improvement in our working capital along with the current assets of the Company. With the subsequent event of closing the debt financing, the Company is in great shape to meet our objectives for the rest of this year.

Although shipments in the first quarter were behind last years shipments, many other factors show that we are in a position to take advantage of the products we've been developing over the past several years. The reduction in overall operating costs of more than \$1 million, the increase in sales year-over-year, as well as the obvious reductions in R&D expenditures are all clear indicators that we are on track to meet the targets that we've discussed with investors over the last several months.

In presentations to investors over the last quarter, we focused attention on companies implementing changes in the industry, which is going to be very advantageous to FLYHT. These changes make our products in demand in the marketplace and are the rollout of FANS and CPDLC and other air navigation systems which lend credence to the work that FLYHT has done for many years.

The second change in the industry that we believe is very important to FLYHT’s ability to assist their customers in this market space, is the increased adoption of iPad technology for the cockpit. We believe that our unique solution of transmitting data through the AFIRS unit to operations centers on the ground will be more rapid when the certified AFIRS 228 product is available for ACARS over iridium and safety services voice later this year.

The third major announcement that happened in the last six months that we believe is going to impact our ability to sell our products, is the certification of the radio network for both data and voice Ineer traffic control realm.

We are also very excited about the development of the China market for FLYHT. The mandate for SatCom voice to be on all aircraft in China and the next three years is a great bellwether for FLYHT. We see the demand for our products in China growing significantly towards the end of this year and for the following two years; we are excited that all the time, effort and money that we have put into the China market is looking like it will pay dividends in the near future. While we understand that the Company may have had a false start in China several years ago, we feel that the opportunity that now exists is real, the certifications are in place, and we anticipate significant opportunities coming our way from China in the next few years.

The first half of this fiscal year will be dedicated to completing the product for certification for Airbus through the L3 program, making sure that we have all of the required documentation for shipments to Chinese airlines, and ensuring that our existing customers are well looked after.

The patience of our investors, the efforts of our management and staff, and the continual support of our customers are what make FLYHT a strong Company, and will see us grow in the future. I would like to thank all of those that support us, and continue the hard work of making the AFIRS UpTime product a superior solution in the aviation industry and look forward to a long and prosperous future for all of us.

Yours Truly

*“Signed”*

Bill Tempany, President and Chief Executive Officer

# MANAGEMENT DISCUSSION & ANALYSIS

This management discussion and analysis (“**MD&A**”) is as of May 7, 2013 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 months ended March 31, 2013 and the accompanying notes. Additional information with respect to FLYHT can be found on SEDAR at [www.sedar.com](http://www.sedar.com). The Company has prepared these interim financial statements and the notes thereto in accordance with IAS 34 – Interim Financial Reporting. They do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended December 31, 2012. 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 IFRS or Generally Accepted Accounting Principles (“**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 before 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 ground support 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 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. Since October the AFIRS 228B's remote configurable intelligence, an industry first, successfully operated on 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 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.

FLYHT’s expertise in airworthiness certification enabled it to join a select group of Canadian companies in October 2008 who are approved by TCCA as a Design Approval Organization (“DAO”). Very few organizations achieve DAO status because of the time and expertise required to meet TCCA standards. FLYHT’s DAO status, along with the delegations it has received, allows the Company to obtain and revise its own STCs with minimal TCCA oversight. This speeds up the process by lessening waiting time, cost and reliance on contractors.

In addition to its DAO status, the Company also has three engineers on staff with delegated authority, allowing them to approve electrical and structural design aspects of an airworthiness certification. If an issue is encountered during the STC process, the delegated staff member(s) have the authority to approve necessary changes and continue the process without the involvement of an external party.

The process to receive a STC takes some time to complete, but always starts with an application for the STC through any one of TCCA, FAA or EASA. Generally, FLYHT starts the process with TCCA by opening an application with the regulator, after which an STC data package is created. The data package consists of the engineering documents that outline how the AFIRS equipment will be installed on the aircraft. Once the data package and first stage of approvals are granted by the regulator, ground and flight tests takes place. To fulfill the flight test requirement, FLYHT must have access to the appropriate type and model of aircraft. This is done in cooperation with an existing or potential customer. Once these tests are completed, FLYHT submits an activation data package to TCCA that enables the AFIRS unit to be integrated with the aircraft systems. If TCCA approves the submission, an STC is issued. To obtain an STC from another regulator, FLYHT prepares an application, which is sent through TCCA to the regulator such as FAA, EASA or CAAC along with the STC package previously approved by TCCA. The regulator reviews the package and issues the STC.

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

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

- ✓ Airbus A319, A320, A321
- ✓ Airbus A330
- ✓ Boeing B737-200, 300, 400, 500
- ✓ Boeing B737-500, 600, 700, 800
- ✓ Boeing B757-200
- ✓ Boeing B767-200, 300
- ✓ Bombardier DHC-8-100, 200, 300, 400
- ✓ Bombardier CRJ100, 200, 400
- ✓ DC-10
- ✓ Fokker F100
- ✓ Hawker Beech 750, 850XP, 900XP
- ✓ Viking Air DHC-7 (LSTC)

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

- ✓ Bombardier CRJ-700, 900
- ✓ Hawker Beech 750, 850XP, 900XP
- ✓ Boeing B777
- ✓ ATR-42, 72
- ✓ Boeing 747-200

FLYHT has received provisions-only STC approvals for AFIRS 228 on the following aircraft and expects full STCs in 2013:

- ✓ Boeing B737 – 600, 700, 800
- ✓ Boeing 767 – 200, 300

FLYHT has STC applications in process for AFIRS 220 or 228, expected to be submitted in 2013, depending on market requirements, for the following aircraft:

- Airbus A319, 320, 321
- Boeing 747-400
- Embraer EMB – 135/145 (includes Legacy)
- McDonnell Douglas MD-81, 82, 83, 87, 88
- Boeing 737 Classics

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



## Trends and Economic Factors

Global Freight Tonne Kilometers (FTKs) were down 2.3% in March compared to March 2012, with only the Middle East and Africa showing an expansion. Asia-Pacific carriers are the largest players in air freight (together they comprise 38.5% of the market). With a 3.3% fall compared to the previous year, this region showed the greatest weakness in terms of actual freight volumes. The US and Europe, however had larger percentage falls (5.2% and 4.0% respectively), but on a smaller market share. Global air freight volumes are now only 1.5% above the October 2012 low point, down from the 3.5% rise that had been reached in January.<sup>1</sup>

Airbus recaptured the aircraft industry's top spot in the first quarter as U.S. rival Boeing fell behind on orders and grappled with the grounding of its newest jet, the 787 Dreamliner, data from both companies showed that Airbus delivered 410 commercial aircraft<sup>2</sup>. Boeing delivered 209 aircraft in the first quarter; backlog remains strong with more than 4,400 airplanes<sup>3</sup>. Embraer delivered 17 commercial jets<sup>4</sup>. Bombardier delivered 50 commercial aircraft during the 2012 fiscal year, compared to 78 for the 2011 fiscal year. During this same period, the Company received 138 net orders for commercial aircraft, compared to 54 for the 2011 fiscal year<sup>5</sup> Bombardier is set to release their Q1 2013 report on May 9, 2013<sup>6</sup>

On the business jet front, shipments increased by 0.6% in 2012 from 2011, though billings declined slightly compared to 2011.<sup>7</sup> The first quarter 2013 aircraft shipment report is scheduled to be published on Wednesday, May 8<sup>th</sup>, 2013.<sup>8</sup> The Executive aviation segment delivered 8 light jets and 4 large jets, totaling 12 aircraft in the 1Q13, with a better mix of large jets, when compared to 1Q12, and a slight reduction of 1 unit in total deliveries.<sup>9</sup> Bombardier delivered 179 business jets, in the 2012 fiscal year compared to 163 for the 2011 fiscal year. During this same period, the Company received 343 net orders for business jets, compared to 191 for the 2011 fiscal year.<sup>10</sup> Bombardier is set to release their Q1 2013 report on May 9, 2013<sup>11</sup>

FLYHT continues to meet the needs of the aviation industry through the introduction of value-added information products and specialty services that build customer value and FLYHT revenues from existing and new installations. Key areas of concentration for the year are the certification of the AFIRS 228 in order to complete Aircraft Communications Addressing and Reporting System (“**ACARS**”) over Iridium functionality; as well, the Company will work with Iridium Satellite Communications (“**Iridium**”) on their voice trials for voice and data safety services messaging. The Company views these initiatives as enhancements to the industry and are steps to strengthen our revenue as we sell AFIRS 228 units and start to collect its recurring revenues.

The weakening of the Canadian dollar relative to the U.S. dollar during the first quarter of 2013 versus the same quarter of 2012 had a positive impact on the Company's revenue and income compared to the same quarter of 2012. 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.

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<sup>1</sup> <http://www.iata.org/pressroom/pr/Pages/2013-04-30-01.aspx>

<sup>2</sup> <http://www.reuters.com/article/2013/04/04/us-airbus-boeing-orders-idUSBRE9330ZO20130404>

<sup>3</sup> <http://boeing.mediaroom.com/index.php?s=43&item=2662>

<sup>4</sup> <http://www.embraer.com/Documents/noticias/054-Results%201Q13-Ins-VPF-I-13.pdf>

<sup>5</sup> <http://bombardier.com/en/corporate/media-centre/press-releases/details?docID=0901260d80285503>

<sup>6</sup> <http://ir.bombardier.com/en/event-calendar>

<sup>7</sup> <http://www.gama.aero/media-center/press-releases/content/gama-releases-2012-year-end-report-and-focuses-opportunities-and>

<sup>8</sup> <http://www.gama.aero/media-center/industry-facts-and-statistics/shipments-billings>

<sup>9</sup> <http://www.embraer.com/Documents/noticias/054-Results%201Q13-Ins-VPF-I-13.pdf>

<sup>10</sup> <http://bombardier.com/en/corporate/media-centre/press-releases/details?docID=0901260d80285503>

<sup>11</sup> <http://ir.bombardier.com/en/event-calendar>



# Contracts and Achievements of Q1 2013

## Contracts

FLYHT Aerospace Solutions Ltd. signed one contract in Q1 2013 for 5 aircraft.

In January, FLYHT signed a contract with a Nigerian airline to install AFIRS 220 on five Airbus A319 and A320 aircraft.

The Company signed a master service agreement in January with Jabil Defense and Aerospace Services, a wholly owned subsidiary of Jabil Circuit, Inc. to manufacture the AFIRS 228 product line.

## Achievements

The Company received an activation Supplemental Type Certificate ("STC") for the AFIRS 228 for the CRJ-900 Series aircraft.

FLYHT received an activation STC for the AFIRS 220 for the Bombardier DHC 8 – Q400 series aircraft.

The Company received a provisions STC for the AFIRS 228 for the Boeing B737 NG series aircraft.

Installations of AFIRS 220 commenced in China on aircraft of three new operators.

Jabil Defense and Aerospace began manufacturing the AFIRS 228B for FLYHT customers globally.

FLYHT delivered a major software release to CMC to further the Royal Saudi Air Force program

The Company commenced shipments of the AFIRS solution to its first South American customer.

## RESULTS OF OPERATIONS – THREE MONTHS ENDED MARCH 31, 2013 AND 2012

### Quarterly Results

	Q1 2013 \$	Q4 2012 \$	Q3 2012 \$	Q2 2012 \$
AFIRS UpTime sales	521,777	1,063,933	555,413	581,290
AFIRS UpTime usage	815,874	774,657	799,872	756,705
Parts	206,672	85,138	48,591	19,168
Services	172,813	296,673	145,885	227,312
Revenue	1,717,136	2,220,401	1,549,761	1,584,475
Loss	970,136	621,446	133,102	1,954,303
Loss before R&D	281,570	40,436	290,563	1,183,274
Loss per share (basic & fully diluted)	0.01	0.00	0.00	0.02

	Q1 2012 \$	Q4 2011 \$	Q3 2011 \$	Q2 2011 \$
AFIRS UpTime sales	264,148	714,476	369,604	377,607
AFIRS UpTime usage	760,392	756,554	734,964	740,471
Parts	49,523	90,659	5,829	62,849
Services	41,106	42,952	329,798	119,984
Revenue	1,115,169	1,604,641	1,440,195	1,300,911
Loss	2,174,901	2,083,371	1,576,944	1,397,442
Loss (income) before R&D	961,742	1,213,147	458,777	841,827
Loss per share (basic & fully diluted)	0.02	0.02	0.01	0.01

## Liquidity and Capital Resources

The Company's cash at March 31, 2013 decreased to nil from \$676,246 at December 31, 2012. The Company's available operating line of \$250,000 was extended by an additional \$300,000, expiring April 30, 2013. The operating line versus cash balance available had a net balance drawn of \$9,573 as at March 31, 2013 (undrawn as of December 31, 2012). The operating line bears an interest rate of Canadian chartered bank prime plus 1.5%, while the extension bears an interest rate of Canadian chartered bank prime plus 5.0%. Both are secured by assignment of cash collateral and a general security agreement.

At March 31, 2013, the Company had negative working capital of \$3,545,752 compared to negative \$2,772,247 as of December 31, 2012, a decline of \$773,505. 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 March 31, 2013 would be negative \$457,027 compared to positive \$742,068 at December 31, 2012.

The Company funded Q1 2013 operations primarily through cash received from sales. If the costs associated with R&D were factored out, there would have been an increase in cash of \$9,680. It is expected that R&D expenses will continue to decrease as the AFIRS 228 project approaches completion. In addition, the resulting increase in cash inflows from sales will reduce the requirement for further funding. The Company believes that if funding is required to meet cash flow requirements in 2013 until the AFIRS 228 is fully functional, it will be able to do so either through debt or equity instruments.

	March 31, 2013	December 31, 2012	Variance
	\$	\$	\$
Cash and cash equivalents	-	676,246	(676,246)
Restricted cash	250,000	250,000	-
Trade and other receivables	1,055,219	1,209,497	(154,278)
Deposits and prepaid expenses	138,957	99,464	39,493
Inventory	1,743,035	1,663,918	79,117
Bank indebtedness	(9,573)	-	(9,573)
Trade payables and accrued liabilities	(3,951,616)	(3,658,254)	(293,362)
Unearned revenue	(2,437,109)	(2,717,245)	280,136
Loans and borrowings	(313,161)	(271,832)	(41,329)
Finance lease obligations	(20,878)	(19,963)	(915)
Current tax liabilities	(626)	(4,078)	3,452
<b>Working capital</b>	<b>(3,545,752)</b>	<b>(2,772,247)</b>	<b>(773,505)</b>
Unearned revenue	2,437,109	2,717,245	(280,136)
Customer deposits	651,616	797,070	(145,454)
<b>Modified working capital</b>	<b>(457,027)</b>	<b>742,068</b>	<b>(1,199,095)</b>

As of March 31, 2013, the Canadian equivalent of the Company's outstanding accounts payable to Sierra Nevada Corporation ("SNC") was \$1,827,312 (December 31, 2012: \$1,790,571) relating to their involvement with the development of the AFIRS 228. If this amount was removed from the working capital it would be negative \$1,718,440 at March 31, 2013 and negative \$981,676 at December 31, 2012. As well, the modified working capital would be a positive \$1,370,285 at March 31, 2013 and positive \$2,532,639 at December 31, 2012. 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 of 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 \$1,827,312 is presently under dispute in the courts. See the Contingency section on page 18 for further clarification.

On April 18, 2013, FLYHT closed the initial tranche of a debt offering of non-convertible debentures. Pursuant to this closing, FLYHT issued an aggregate \$1,855,000 of debentures. The debentures mature on June 30, 2016 and bear interest at a rate of 12% per annum on the contributed amounts, which shall be accrued and paid annually in arrears commencing December 1, 2013. Purchasers of debentures will receive a capital discount premium of 10% on the financing, meaning that for every \$1.00 debenture acquired, FLYHT shall owe, on the maturity date, principal equal to \$1.10 to the debenture holder. The purchasers of the debentures will also be issued one common share of the Corporation for every \$1.00 principal amount of debentures acquired pursuant to the offering. A total of 1,855,000 common shares were issued under this tranche. All of the securities issued hereunder are subject to a 4-month hold period. The debentures will not be listed on any stock exchange and are not convertible into common shares. The debentures are secured against all personal property of FLYHT, including FLYHT's intellectual property and are subordinated in right of payment to all existing and future secured bank and/or governmental indebtedness of FLYHT and any existing security already registered against FLYHT's assets.

As at May 7, 2013, FLYHT's issued and outstanding share capital was 142,241,166.

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 three months ending March 31, 2013 and 2012. Payment was received for 11 installation kits in the first quarter of 2013, compared to 17 received in the first quarter of 2012.

	Q1 2013 \$	Q1 2012 \$	Variance \$
Opening balance	797,070	980,955	(183,885)
Payments received from customers	117,635	694,522	(576,887)
Moved to unearned revenue	(263,089)	(301,973)	38,884
<b>Balance, March 31</b>	<b>651,616</b>	<b>1,373,504</b>	<b>(721,888)</b>

## Unearned revenue

The chart below outlines the movement in the Company's unearned revenue throughout the three months ending March 31, 2013 and 2012. Revenue was recognized for 13 installation kits in 2013's first quarter compared to 7 in the first quarter of 2012. In the first quarter of 2013, 25.0% of the unearned revenue balance at December 31, 2012 was recognized as earned revenue (Q1 2012: 12.1%).

	Q1 2013 \$	Q1 2012 \$	Variance \$
Opening balance	2,717,245	1,897,204	820,041
AFIRS UpTime sales: shipped, not accepted	263,089	301,973	(38,884)
AFIRS UpTime usage: prepaid	153,624	89,588	64,036
AFIRS UpTime sales: revenue recognized	(521,776)	(264,149)	(257,627)
AFIRS UpTime usage: revenue recognized	(110,693)	(42,092)	(68,601)
License fees: revenue recognized	(64,380)	(64,380)	-
<b>Balance, March 31</b>	<b>2,437,109</b>	<b>1,918,144</b>	<b>518,965</b>

## Revenue

For the revenue categories listed in the Revenue sources chart, **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, including two FLYHT set up in Nigeria.

First quarter revenue increased 54.0% from \$1,115,169 in Q1 2012 to \$1,717,136 in Q1 2013, due to increases in AFIRS Uptime sales of 97.5%, AFIRS Uptime usage of 7.3%, Parts revenue of 317.3% and Services revenue of 320.4%.

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 March 31, 2013, there was one customer with a rental type contract (2012: one customer). 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

	Q1 2013 \$	Q1 2012 \$	Variance \$
AFIRS UpTime sales	521,777	264,148	257,629
AFIRS UpTime usage	815,874	760,392	55,482
Parts	206,672	49,523	157,149
Services	172,813	41,106	131,707
<b>Total</b>	<b>1,717,136</b>	<b>1,115,169</b>	<b>601,967</b>

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 47.5% of the Company's revenue in the first quarter of 2013 was recurring, compared to 68.2% in the first quarter of 2012. Recurring revenue as a percentage of overall revenue will fluctuate from period to period depending on the mix of revenue during each period. Recurring revenue from FLYHT's existing client base is expected to continue to expand throughout 2013 and future years.

## Geographical sources of revenue

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

	Q1 2013 \$	Q1 2012 \$	Q1 2013 %	Q1 2012 %
North America	1,162,738	597,457	67.7	53.5
South/Central America	96,485	103,833	5.6	9.3
Africa/Middle East	174,951	198,098	10.2	17.8
Europe	7,843	112,148	0.5	10.1
Australasia	154,835	97,628	9.0	8.8
Asia	120,284	6,005	7.0	0.5
<b>Total</b>	<b>1,717,136</b>	<b>1,115,169</b>	<b>100.0</b>	<b>100.0</b>

## Gross Profit 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 first quarter of 2013 was 33.4% compared to 45.2% in 2012's first quarter. The decrease was due to a difference in the mix of revenue sources, as AFIRS Uptime usage, Parts sales, and Services 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 Profit
Q1 2013	66.6%
Q4 2012	65.9%
Q3 2012	60.1%
Q2 2012	43.7%
Q1 2012	54.8%
Q4 2011	40.2%
Q3 2011	62.7%
Q2 2011	59.8%



## 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 18.

### Distribution expenses

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

Major Category	Q1 2013 \$	Q1 2012 \$	Variance \$
Salaries and benefits	419,113	476,707	(57,594)
Share based compensation	1,125	15,473	(14,348)
Contract labour	63,976	179,843	(115,867)
Office	87,958	99,003	(11,045)
Travel	84,388	103,145	(18,757)
Equipment & maintenance	3,750	7,020	(3,270)
Depreciation	10,678	13,281	(2,603)
Marketing	4,530	16,314	(11,784)
Other	5,347	58,182	(52,835)
<b>Total</b>	<b>680,865</b>	<b>968,968</b>	<b>(288,103)</b>

**Salaries and benefits** decreased in 2013 as compared to 2012 mainly due to decreased staffing requirements to meet AFIRS 228 development needs. The decreased costs were allocated between distribution and research and development expenses as the decreased staff's efforts had been split between meeting the needs of existing and future customers, and AFIRS 228 development.

**Share based compensation** decreased in the quarter due to an option grant in 2012 that was not repeated in 2013, partially offset by the vesting in Q1 2013 of options granted in 2012.

**Contract labour** decreased compared to Q1 2012 due to a reduction in contractors supplying distribution related services.

**Office** expenses decreased from 2012 to 2013 as a result of cost containment measures.

**Travel** expenses decreased in 2013 versus 2012 largely as the result of decreased travel and meals associated with business aviation sales activities. Fluctuations in travel will occur 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, travel expenses will increase on an annual basis and quarterly fluctuations will continue to occur.

**Marketing** expenses decreased in the quarter due to the reduced requirement for marketing collateral, 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 decreased from 2012 to 2013 due to differences in bad debt adjustments. Chapter 11 steps were taken by three customers in the first quarter of 2012, whereas a smaller adjustment was required in Q1 2013 to account for a Chapter 7 filing by one customer who had declared Chapter 11 in 2012.

## 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	Q1 2013 \$	Q1 2012 \$	Variance \$
Salaries and benefits	295,536	332,508	(36,972)
Share based compensation	36,633	-	36,633
Contract labour	41,370	14,020	27,350
Office	76,048	84,579	(8,531)
Legal fees	12,687	45,965	(33,278)
Audit and accounting	27,000	25,000	2,000
Investor relations	49,903	10,917	38,986
Brokerage, stock exchange, and transfer agent fees	9,024	9,162	(138)
Travel	31,527	17,295	14,232
Equipment and maintenance	13,547	12,584	963
Depreciation	5,979	7,391	(1,412)
Other	2,118	3,018	(900)
<b>Total</b>	<b>601,372</b>	<b>562,439</b>	<b>38,933</b>

**Salaries and benefits** decreased throughout Q1 2013 compared with Q1 2012 due to the reduction of a full time investor relations (“IR”) staff member, replaced by the reengagement of an IR consultant in Q3 of 2012.

**Share based compensation** increased in the quarter due to the recognition in 2013 of the partial vesting of options granted to investment relations advisors in the third quarter of 2012 and the first quarter of 2013.

**Contract labour** increased due to the engagement in mid-2012 of a consultant working to identify new corporate opportunities.

**Office** expenses decreased from 2012 to 2013 as a result of cost containment measures.

**Legal fees** decreased in Q1 2013 compared to Q1 2012, mainly due to the Q2 2012 closure of legal proceedings with the Toronto-based company.

**Investor relations** expenses increased in the first quarter of 2013, due to the reengagement of an IR consultant near the end of 2012 and the addition of a second IR consultant in the first quarter of 2013.

**Travel** expenses increased in the quarter, relating mainly to investor relations. 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.

## Research and development expenses (recovery)

Major Category	Q1 2013 \$	Q1 2012 \$	Variance \$
Salaries and benefits	385,059	394,864	(9,805)
Contract labour	197,035	610,526	(413,491)
Office	25,655	153,062	(127,407)
Travel	13,722	6,007	7,715
Equipment & maintenance	19,404	11,804	7,600
Components	40,836	95,717	(54,881)
Government grants	-	(64,137)	64,137
Depreciation	4,415	5,316	(901)
Other	2,440	-	2,440
<b>Total</b>	<b>688,566</b>	<b>1,213,159</b>	<b>(524,593)</b>

**Salaries and benefits** expended on research and development decreased throughout the first quarter of 2013 compared with the same period last year, as the 228B moved toward full production.

**Contract labour** decreased from Q1 2012, mainly as the result of reduced utilization of consultants for hardware development. With the certification phase of the AFIRS 228 in upcoming quarters the requirement for consultants will increase in order to obtain the necessary skills and experience to certify the product. It is not anticipated that the requirement for consultants will increase to the level that was required in 2012.

**Office** expenses decreased in the first quarter of 2013 compared to 2012 as a result of decreased costs associated with patent applications as well as legal fees associated with the SNC legal action.

**Components** decreased in the quarter, due to a decreased requirement for test parts for the development of the AFIRS 228.

**Government grants** variance is due to the receipt of \$64,137 in Q1 2012 through the SADI grant, while no government funding was received in Q1 2013.

## Net finance income (costs)

Major Category	Q1 2013 \$	Q1 2012 \$	Variance \$
Interest income	-	72	(72)
Net foreign exchange gain (loss)	(54,249)	28,666	(82,915)
Bank service charges	(5,323)	(5,750)	427
Interest expense	(1,743)	(2,415)	672
Government grant accretion	(27,917)	(11,254)	(16,663)
Debenture interest and accretion	(98,578)	(96,042)	(2,536)
Debenture cost amortization	(19,314)	(19,529)	215
<b>Net finance costs</b>	<b>(207,124)</b>	<b>(106,252)</b>	<b>(100,872)</b>

**Net foreign exchange gains** were recorded in the first quarter 2012 as compared to a net loss in the first quarter of 2013 due to the weakening of the Canadian dollar in relation to the U.S. dollar.

**Government grant accretion** is the recognition of the interest component of the SADI grant, which was higher in the first quarter of 2013 than 2012 as more funding was received throughout the latter portion of 2012.

## Net loss

Major Category	Q1 2013 \$	Q1 2012 \$	Variance \$
Net loss	970,136	2,174,901	(1,204,765)
Net loss without R&D	281,570	961,742	(680,172)

## 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 the first quarter of 2013, 93.7% of the Company's gross sales were made in U.S. dollars, compared to 98.1% in the same period of 2012. 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 certain services and products related to cost of sales, which creates a natural hedge.

## Transactions with Related Parties

- As of December 31, 2012, the Company ceased engaging a company owned by a director to supply consulting services. The related party provided business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company.
- During the first quarter of 2013, 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 into the first quarter of 2012. The related party provided 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		March 31	
	2013	2012	2013	2012
	\$	\$	\$	\$
(a)	-	22,412	-	14,932
(b)	-	17,984	-	-
<b>Total</b>	-	<b>40,396</b>	-	<b>14,932</b>

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.

March 31, 2013	< 2 months	2-12 months	1-2 years	2-5 years	> 5 years	Total
	\$	\$	\$	\$	\$	\$
Accounts payable	955,092	33,006	-	-	-	988,098
Accounts payable – SNC*	1,827,312	-	-	-	-	1,827,312
Compensation and statutory deductions	270,004	40,449	-	-	-	310,453
Finance lease liabilities	4,058	20,291	7,941	-	-	32,290
Accrued liabilities	45,081	130,040	-	-	-	175,121
Loans and borrowings	38,172	274,988	3,492,239	253,612	1,464,132	5,523,143
<b>Total</b>	<b>3,139,719</b>	<b>498,774</b>	<b>3,500,180</b>	<b>253,612</b>	<b>1,464,132</b>	<b>8,856,417</b>

\* See contingencies section on page 18.

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

Under IRAP, the outstanding balance at March 31, 2013 was \$41,328 compared to \$116,024 at March 31, 2012. The initial amount is being repaid as a percentage of gross revenues over a 5 to 10 year period commencing October 2005.

Under TPC, the Company has an outstanding balance of \$28,074 at March 31, 2013, compared to \$47,186 at March 31, 2012. The initial amount is being repaid based on 15% of the initial contribution, which equates to \$19,122 per year for a 10 year repayment period. The annual 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 March 31, 2013, 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 will be 3.5% of the total contribution received and will increase annually by 15% until April 30, 2028 when the final payment will be 24.5% of the total contribution received.

During the first quarters of both 2013 and 2012, FLYHT did not enter into any new lease agreements. Minimum lease payments are as follows for existing finance leases:

Year	Total \$
2013	18,262
2014	14,028
<b>Total</b>	<b>32,290</b>

The imputed interest included in the payments is \$3,813 (2012 - \$10,791) leaving a total obligation of \$28,477 (2012 - \$60,913).

## Contingencies

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 \$1,827,312, 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 2012, 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 March 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, 2012. 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 2012, SNC filed an action in Utah alleging that FLYHT failed to pay \$2,042,000 USD.

As all invoices presented to the Company by SNC have been accrued, management does not expect the outcome to have a material effect on the Company's financial position.

## Subsequent Event

On April 18, 2013, FLYHT closed an anticipated initial tranche of a debt offering of non-convertible debentures. Pursuant to this closing, FLYHT will issue an aggregate \$1,855,000 of debentures. The debentures will mature on June 30, 2016 and bear interest at a rate of 12% per annum on the contributed amounts, which shall be accrued and paid annually in arrears commencing December 1, 2013. Purchasers of debentures will receive a capital discount premium of 10% on the financing, meaning that for every \$1.00 debenture acquired, FLYHT shall owe, on the maturity date, principal equal to \$1.10 to the debenture holder. The purchasers of the debentures will also be issued one common share of the Corporation for every \$1.00 principal amount of debentures acquired pursuant to the offering. A total of 1,855,000 common shares were issued under this tranche. All of the securities issued hereunder are subject to a 4-month hold period. The debentures will not be listed on any stock exchange and are not convertible into common shares.

The debentures are secured against all personal property of FLYHT, including FLYHT's intellectual property and are subordinated in right of payment to all existing and future secured bank and/or governmental indebtedness of FLYHT and any existing security already registered against FLYHT's assets.

## Recent Accounting Pronouncements

The following new standards, interpretations, amendments and improvements to existing standards issued by the IASB or International Financial Reporting Interpretations Committee ("IFRIC") were adopted as of January 1, 2013 without any material impact to FLYHT's Financial Statements: IFRS 7 *Financial Instruments: Disclosures*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of interests in Other Entities*, IFRS 13 *Fair Value Measurement*, and IAS 9 *Employee Future Benefit*.

The following new accounting pronouncements have been issued but are not effective and may have an impact on the Company. All of the following new or revised standards permit early adoption with transitional arrangements depending upon the date of initial application:

IFRS 7 / IAS 32 – Offsetting Financial Assets and Liabilities clarifies that an entity currently has a legally enforceable right to set-off if it is not contingent on a future event, situations under which it is enforceable, and defines related disclosure requirements (January 1, 2014).

IFRS 9 – Financial Instruments replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. (January 1, 2015).

IAS 1 – Presentation of Financial Statements requires that an entity present separately the items of OCI that may be reclassified to profit and loss in the future from those that would never be reclassified (annual periods beginning on or after July 1, 2013).

The Company has not completed its evaluation of the effect of adopting these standards on its condensed consolidated interim 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 month periods ended March 31, 2013 and March 31, 2012.

# CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION (UNAUDITED)

	March 31, 2013 \$	December 31, 2012 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	-	676,246
Restricted cash	250,000	250,000
Trade and other receivables	1,055,219	1,209,497
Deposits and prepaid expenses	138,957	99,464
Inventory	1,743,035	1,663,918
<b>Total current assets</b>	<b>3,187,211</b>	<b>3,899,125</b>
<b>Non-current assets</b>		
Property and equipment	219,653	240,725
Rental assets	34,728	38,726
Intangible assets	27,975	62,623
Inventory	694,914	727,773
<b>Total non-current assets</b>	<b>977,270</b>	<b>1,069,847</b>
<b>Total assets</b>	<b>4,164,481</b>	<b>4,968,972</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	9,573	-
Trade payables and accrued liabilities	3,951,616	3,658,254
Unearned revenue	2,437,109	2,717,245
Loans and borrowings	313,161	271,832
Finance lease obligations	20,878	19,963
Tax liabilities	626	4,078
<b>Total current liabilities</b>	<b>6,732,963</b>	<b>6,671,372</b>
<b>Non-current liabilities</b>		
Loans and borrowings	3,184,086	3,104,967
Finance lease obligations	7,599	13,175
Provisions	39,205	46,452
<b>Total non-current liabilities</b>	<b>3,230,890</b>	<b>3,164,594</b>
<b>Total liabilities</b>	<b>9,963,853</b>	<b>9,835,966</b>
<b>Equity (deficiency)</b>		
Share capital	39,877,966	39,877,966
Convertible debenture – equity feature	231,318	231,318
Warrants	3,340,222	3,340,222
Contributed surplus	6,995,567	6,957,809
Accumulated other comprehensive income (loss)	-	-
Deficit	(56,244,445)	(55,274,309)
<b>Total equity (deficiency)</b>	<b>(5,799,372)</b>	<b>(4,866,994)</b>
<b>Total liabilities and equity</b>	<b>4,164,481</b>	<b>4,968,972</b>

See accompanying notes to condensed consolidated interim financial statements.

Going concern (note 2d)

Contingencies (note 8)

On behalf of the board



Director – Douglas Marlin



Director – Paul Takalo

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

	For the three months ended March 31, 2013 \$	For the three months ended March 31, 2012 \$
Revenue (note 7)	1,717,136	1,115,169
Cost of sales	573,487	503,632
<b>Gross profit</b>	<b>1,143,649</b>	<b>611,537</b>
Other (income)	(64,380)	(64,380)
Distribution expenses	680,865	968,968
Administration expenses	601,372	562,439
Research and development expenses	688,566	1,213,159
<b>Results from operating activities</b>	<b>(762,774)</b>	<b>(2,068,649)</b>
Finance (income)	-	(28,738)
Finance costs	207,124	134,990
<b>Net finance costs</b>	<b>(207,124)</b>	<b>(106,252)</b>
<b>Loss before income tax</b>	<b>(969,898)</b>	<b>(2,174,901)</b>
Income tax expense	238	-
<b>Loss for the period</b>	<b>(970,136)</b>	<b>(2,174,901)</b>
Foreign currency translation	-	98
<b>Total comprehensive loss for the period</b>	<b>(970,136)</b>	<b>(2,174,803)</b>
<b>Earnings (loss) per share</b>		
Basic and diluted loss per share (note 6)	(0.01)	(0.02)

See accompanying notes to condensed consolidated interim financial statements.

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (DEFICIENCY) (UNAUDITED)

For the three months ended March 31, 2013 and 2012

	Share Capital \$	Convertible Debenture \$	Warrants \$	Contributed Surplus \$	Foreign Currency Translation Reserve* \$	Deficit \$	Total Equity (Deficit) \$
<b>Balance at January 1, 2012</b>	36,741,492	231,318	2,499,778	6,622,606	-	(50,390,557)	(4,295,363)
Loss for the period	-	-	-	-	-	(2,174,901)	(2,174,901)
Foreign currency translation differences	-	-	-	-	98	-	98
<b>Total comprehensive loss for the period</b>	-	-	-	-	98	(2,174,901)	(2,174,803)
<b>Contributions by and distributions to owners</b>							
Share-based payment transactions	-	-	-	15,473	-	-	15,473
Share options exercised	2,178	-	-	(678)	-	-	1,500
Total contributions by and distributions to owners	2,178	-	-	14,795	-	-	16,973
<b>Balance at March 31, 2012</b>	36,743,670	231,318	2,499,778	6,637,401	98	(52,565,458)	(6,453,193)
<b>Balance at January 1, 2013</b>	39,877,966	231,318	3,340,222	6,957,809	-	(55,274,309)	(4,866,994)
Loss for the period	-	-	-	-	-	(970,136)	(970,136)
<b>Total comprehensive loss for the period</b>	-	-	-	-	-	(970,136)	(970,136)
<b>Contributions by and distributions to owners</b>							
Share-based payment transactions	-	-	-	37,758	-	-	37,758
Total contributions by and distributions to owners	-	-	-	37,758	-	-	37,758
<b>Balance at March 31, 2013</b>	39,877,966	231,318	3,340,222	6,995,567	-	(56,244,445)	(5,799,372)

\*Accumulated other comprehensive income (loss)

See accompanying notes to condensed consolidated interim financial statements.

# CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

	For the three months ended March 31, 2013 \$	For the three months ended March 31, 2012 \$
<b>Cash flows from operating activities</b>		
Loss for the period	(970,136)	(2,174,901)
Adjustments for:		
Depreciation	21,072	25,988
Depreciation of rental assets	3,998	160
Amortization of intangible assets	34,648	34,648
Convertible debenture accretion	98,578	96,042
Amortization of debenture issue costs	19,314	19,529
Government grant accretion	27,917	11,254
Government grant	-	(64,137)
Equity-settled share-based payment transactions	37,758	15,473
Change in inventories	(46,258)	68,878
Change in trade and other receivable	134,701	115,684
Change in deposits and prepaid expenses	(39,493)	(61,568)
Change in trade payables and accrued liabilities	261,874	392,393
Change in provisions	(10,699)	(16,436)
Change in unearned revenue	(280,136)	20,940
Unrealized foreign exchange	61,450	(30,032)
Interest expense	1,743	2,415
Interest paid	(1,743)	(2,415)
Income tax expense	238	-
Income tax paid	(3,690)	-
<b>Net cash used in operating activities</b>	<u>(648,864)</u>	<u>(1,546,085)</u>
<b>Cash flows from investing activities</b>		
Acquisitions of property and equipment	-	(5,155)
Disposal (acquisitions) of rental assets	-	10,797
Interest income	-	(72)
Interest received	-	72
<b>Net cash from investing activities</b>	<u>-</u>	<u>5,642</u>
<b>Cash flows from financing activities</b>		
Proceeds from exercise of share options and warrants	-	1,500
Proceeds from government grant	-	92,851
Repayment of loans and borrowings	(25,361)	(18,526)
Bank indebtedness	9,573	-
Payment of finance lease liabilities	(4,661)	(20,940)
<b>Net cash from (used in) financing activities</b>	<u>(20,449)</u>	<u>54,885</u>
<b>Net decrease in cash and cash equivalents</b>	(669,313)	(1,485,558)
Cash and cash equivalents at January 1	676,246	1,928,065
Effect of exchange rate fluctuations on cash held	(6,933)	(30,494)
<b>Cash and cash equivalents</b>	<u>-</u>	<u>412,013</u>

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. FLYHT is a public company incorporated under the Canada Business Corporations Act, and is domiciled in Canada. The Company has been listed on the TSX Venture Exchange since March 2003, first as TSX.V: AMA, and as TSX.V FLY since the Company's official name change in May 2012. The Company's head office is 200W, 1144 – 29<sup>th</sup> Avenue NE, Calgary, Alberta T2E 7P1.

The condensed consolidated interim financial statements of the Company as at and for the three months ended March 31, 2013 and 2012 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, 2012 are available upon request from the Company's registered office or at [www.flyht.com](http://www.flyht.com).

## 2. BASIS OF PREPARATION

### (a) Statement of compliance

These interim financial statements and the notes thereto have been prepared in accordance with IAS 34 – Interim Financial Reporting. They do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Company as at and for the year ended December 31, 2012. The interim financial statements were authorized for issue by the Board of Directors on May 7, 2013.

### (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) 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 March 31, 2013, the Company had negative working capital of \$3,545,752, a deficit of \$56,244,445, a net loss of \$970,136 and negative cash flow from operations of \$648,864.

The Company has incurred significant operating losses and negative cash flows from operations over the past three months. 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. These material uncertainties may cast significant doubt upon the Company's ability to continue as a going concern.

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.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out in FLYHT's December 31, 2012 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. DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods.

- (a) Share based payment transactions: measured using the Black-Scholes option pricing model; and
- (b) Loans and borrowings: for measurement purposes, fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the inception of the loan. In respect of the liability component of convertible debenture, the market rate of interest is determined by reference to similar liabilities that do not have a conversion feature.

### 5. CAPITAL AND OTHER COMPONENTS OF EQUITY

The Company grants stock options to its directors, officers, employees and consultants. In the first quarter of 2013 the Company granted 487,500 stock options to two consultants under the stock option plan. The stock options expire December 31, 2016, and have an exercise price of \$0.25 per share. Of the options granted, 87,500 were issued to a consultant and vested immediately and 400,000 were issued to an investor relations consultant and vest 25% per quarter March 31, June 30, September 30, and December 31, 2013. The fair value of the options granted was determined based on the estimated fair value of services to be received.

### 6. EARNINGS PER SHARE

#### Basic earnings per share

The calculation of basic and diluted earnings per share for the three months ended March 31, 2013 was based on a weighted average number of common shares outstanding of 140,386,166 (2012: 118,626,151). The calculation did not include stock options of 6,758,000 (2012: 4,479,991), warrants of 32,133,969 (2012: 20,535,610) and convertible debentures of 7,897,500 based on the conversion price of \$0.40 per common share because they would be anti-dilutive.

	<b>For the three months ended</b>	
	<b>March 31</b>	
	<b>2013</b>	<b>2012</b>
	<b>\$</b>	<b>\$</b>
Loss attributable to common shareholders	970,136	2,174,901
Basic and diluted loss per share	0.01	0.02

## 7. OPERATING SEGMENTS

The Company has one operating segment.

### Geographical Information

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

	<b>March 31, 2013</b>	<b>March 31, 2012</b>
	<b>\$</b>	<b>\$</b>
North America	1,162,738	597,457
South / Central America	96,485	103,833
Africa / Middle East	174,951	198,098
Europe	7,843	112,148
Australasia	154,835	97,628
Asia	120,284	6,005
<b>Total</b>	<b>1,717,136</b>	<b>1,115,169</b>

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

### Major customers

Revenues from the three largest customers represent approximately 42.5% of the Company's total revenues for the three months ended March 31, 2013 (2012: 25.7%).

## 8. CONTINGENCY

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 \$1,827,312, 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 March 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, 2012. 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.

As all invoices presented to the Company by SNC have been accrued, management does not expect the outcome to have a material effect on the Company's financial position.

## 9. RELATED PARTIES

- a) Throughout 2012 the Company engaged in transactions with a company owned by a director to supply consulting services. The related party provided business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company.
- b) Throughout 2012 the Company engaged in transactions with a company owned by a director to supply consulting services. The related party provided business development services such as market analysis and corporate introductions related to the commercial aviation initiatives of the Company.

	<b>Included in contract labour:</b>		<b>Included in accounts payable and accrued liabilities:</b>	
	<b>For the three months ended March 31</b>		<b>March 31</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
(a)	-	22,412	-	14,932
(b)	-	17,984	-	-
Total	-	40,396	-	14,932

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.

## 10. SUBSEQUENT EVENT

On April 18, 2013, FLYHT closed the initial tranche of a debt offering of non-convertible debentures. Pursuant to this closing, FLYHT will issue an aggregate \$1,855,000 of debentures. The debentures will mature on June 30, 2016 and bear interest at a rate of 12% per annum on the contributed amounts, which shall be accrued and paid annually in arrears commencing December 1, 2013. Purchasers of debentures will receive a capital discount premium of 10% on the financing, meaning that for every \$1.00 debenture acquired, FLYHT shall owe, on the maturity date, principal equal to \$1.10 to the debenture holder. The purchasers of the debentures will also be issued one common share of the Corporation for every \$1.00 principal amount of debentures acquired pursuant to the offering. A total of 1,855,000 common shares were issued under this tranche. All of the securities issued hereunder are subject to a 4-month hold period. The debentures will not be listed on any stock exchange and are not convertible into common shares.

The debentures are secured against all personal property of FLYHT, including FLYHT's intellectual property and are subordinated in right of payment to all existing and future secured bank and/or governmental indebtedness of FLYHT and any existing security already registered against FLYHT's assets.

# CORPORATE INFORMATION

## Registrar and Transfer Agent

Valiant Trust Company  
Telephone: 1-866-313-1872  
Email: [inquires@valianttrust.com](mailto:inquires@valianttrust.com)  
[www.valianttrust.com](http://www.valianttrust.com)

## Share Listing

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

## Investor Relations

Email: [investors@flyht.com](mailto:investors@flyht.com)  
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## Directors

Bill Tempany  
Richard Hayden  
Doug Marlin

Mike Brown  
Paul Takalo, CA  
Jacques Kavafian  
Jack Olcott

President & CEO, FLYHT Aerospace Solutions Ltd.  
Director, FLYHT Aerospace Solutions Ltd.  
Chairman, FLYHT Aerospace Solutions Ltd. & President,  
Marlin Ventures Ltd.  
Partner, Geselbracht Brown  
Vice-President, Standen's Limited  
Vice President, Toll Cross Securities Inc.  
President, General Aviation Company

## Officers

Bill Tempany  
Thomas French, CGA  
Matt Bradley  
Jeff Brunner

President & CEO  
VP Finance and CFO  
VP Business Development  
VP Operations

## Auditor

KPMG LLP

Calgary, Alberta

## Legal Counsel

Chris Croteau

Tingle Merrett LLP

## Head Office

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