

AeroMechanical Services Ltd.

2010 First Quarter Report

TSX.V: AMA

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AeroMechanical Services Ltd.



Letter to the Shareholders

To Our Shareholders,

We are pleased to update you on our assessment of the global aviation market and progress toward key strategic objectives that are building the long term value of our company. I write this after having been in Europe during the volcanic eruption and a few days after flying back (around the persistent ash cloud) from the cautiously upbeat European Business Aircraft Convention and Exhibition (EBACE) in Geneva.

As the world digs out of the unprecedented global economic recession, it is worth putting our industry and our products in context. First, looking over our shoulder, it goes without saying that the airlines, cargo operators, business aviation operators, and manufacturers have been severely impacted during the slowdown, resulting in rationalization of capacity, players, and routes, production cutbacks and layoffs, as well as an intense examination of ways to increase productivity and lower costs. In the process, capital spending has been deferred on a broad scale, resulting in delays in some of our expected bookings and deliveries. However, as we have seen during the Haitian tragedy and the continuing Eyjafjallajökull volcanic activity, aviation is increasingly essential to our human endeavours and economic well being. The short-term effects on the industry that are tied closely to regional and global GDP do not alter the fundamental and increasing role of aviation in the world economy. Despite the well-publicized effects of increasing fuel prices and the disruption caused by the volcano, a leading indicator of the recovery in global demand for aircraft, Boeing's share price, has doubled in the past 12 months, so we believe that optimism is justified. Looking further ahead, Boeing and Airbus project a global fleet of airliners of approximately 29,000 aircraft in 2028, up from today's active fleet of roughly 19,000. While the North American market is saturated and will show the slowest growth of any major region, Latin America, the Middle East, Africa, and most parts of Asia are projected as the fastest growing markets for adding capacity. Consequently, these are areas in which AMA has been concentrating our airline sales focus, with encouraging results. Conversions of existing passenger aircraft to freighters - an area that AMA has developed through our agreement with AerCap Holdings N.V. - are projected to be in the range of 2,000-4,000, as the value of air freight increases year over year (now approaching 40% of the value of all goods transported by all means). Business aviation, with its global jet fleet of 15,000 aircraft, has carved out its niche to provide timely point-to-point transportation of key individuals in a productive environment, and it is showing early signs of recovering from its worst downturn ever, but, as just presented by The Teal Group at EBACE, the recovery will take time. Finally, the role of military transports becomes more global, important, and complex every day.

The challenges of the past 24 months have underscored the fact that all segments of the global aviation industry share a common need to reduce costs, improve productivity, and maintain high safety standards. It is these core needs that are addressed squarely by AMA's products and services.

During the chaos in the global economy, some significant events have occurred that will have a significant impact on AMA's future. On the regulatory front, the EU published rulemaking (EC 29/2009) that requires most aircraft to add capability for improved communications on a schedule with

a final deadline of February, 2015. AMA has responded to this key development with work on a new version of afirs (the “228”) with our partner Sierra Nevada Corporation (“SNC”), made appropriate adjustments in our sales and marketing approach, and signed an agreement with a European launch customer. The 228 prototype hardware has been produced as we head toward an initial certification and first customer delivery in Q3-Q4 2010. Next, our decision in mid-2009 to invest in a public demonstration of “black box” data streaming from in-service aircraft (leading to a product called “FLYHTStream™”) put us on aviation’s world stage and changed the way in which we are viewed by regulators, manufacturers, airlines, and other major suppliers. In Q1 2010, we have made significant progress in projecting afirs and FLYHTStream as a leading solution as a member of a European consortium commissioned to recommend improved tracking capabilities for oceanic crossings (OPTIMI: Oceanic Position Tracking Improvement Monitoring Initiative); we also now serve on a working group headed by the French Bureau d’Enquêtes et d’Analyses (BEA) that will recommend to the International Civil Aviation Organization (“ICAO”) new technologies, such as FLYHTStream, to avoid incidents such as the Air France flight 447 loss last year.

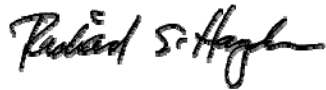
Our partnership with L-3 Communications (“L-3”) gives us a viable path to the original equipment manufacturers (OEMs) globally by drawing upon L-3’s corporate strength, portfolio, and established position as an approved (and often preferred) supplier to OEMs and large carriers. We are receiving excellent support from L-3 with large carriers in Asia, OEMs, and a leading business aviation fleet operator.

Some highlights of Q1 include: signing 2 contracts in sub-Saharan Africa, including one to establish a regional aircraft tracking capability and the other with a new operator that utilizes the STCs we invested in last year for a class of business aircraft; entering afirs-equipped C-130 aircraft into service for our first military customer; negotiating a preliminary agreement with AerCap, B.V. to provide the afirs 228 for Airbus A320 passenger-to-freighter conversions; gaining regulatory clearance to begin installations on an important Mideast charter airline; achieving successful in-service evaluation (ISE) of afirs UpTime and our fuel management product with a major business aviation fleet operator; and the aforementioned positioning of afirs and FLYHTStream in connection with future rulemaking activities in Europe. As we learn more about the effects of the volcanic ash on aircraft operations, we are studying ways in which our afirs technology can be adapted to monitoring the impacts of the silica in the ash on engine wear and performance.

While the jury is still out on 2010 and beyond, early indications are that the aviation industry is poised for a slow but steady recovery. Things take a long time in aviation in good times and even longer in tough times, but maintaining a presence pays off. We have announced significant deals this quarter that are a culmination of persistent and diligent pursuit by our team over the several years. Our diligence in the marketplace is being rewarded and our industry-leading technologies such as the FLYHTStream product, fuel management products to reduce costs and help reduce greenhouse gas emissions, and the afirs 228 to support compliance with emerging air traffic control rules, continue to provide results for our customers and attract new prospects. We have strengthened our balance sheet and are poised to deliver superior products to this huge global industry as it emerges from the recession.

We want to thank our shareholders for their confidence and patience, our staff for their dedication and efforts, and our board of directors for their unwavering support as we navigate the uncertainties of the global economy.

Yours truly,



Richard E. Hayden

President

Management Discussion & Analysis

This management discussion and analysis (“MD&A”) is as of May 20, 2010 and should be read in conjunction with the unaudited interim consolidated financial statements of AeroMechanical Services Ltd. (“AMA” or the “Company”) for the three months ended March 31, 2010 and the accompanying notes. Additional information with respect to AMA can be found on SEDAR at www.sedar.com which is supplemental to the unaudited interim consolidated financial statements and notes for the three month period ended March 31, 2010.

Overview

AMA is a designer, developer and service provider of patented innovative solutions to the global aerospace business. The Company’s solutions are designed to improve the productivity and profitability of our customers’ assets.

The major products and services of the Company are Automated Flight Information Reporting System (afirs™), UpTime™, Fuel Initiative Reporting System Tracker (FIRST™), Fuel Management System, Underfloor Stowage Unit, and AeroQ™. These products and services are marketed globally by a team of several employees and agents based in Canada (Calgary and Ottawa), United States (Boston and Portland), United Kingdom, France, Switzerland, and Argentina. One of the Calgary staff is currently spending 95% of his time in China working on opportunities there.

Non-GAAP Financial Measures

The Company reports its financial results in accordance with generally accepted accounting principles (GAAP). It also occasionally uses certain non-GAAP financial measures, such as working capital, modified working capital and cash revenue. AMA defines working capital as current assets less current liabilities. The Company defines modified working capital as current assets less current liabilities not including customer deposits or the current portion of unearned revenue. AMA defines cash revenue as financial statement revenue plus arrangement consideration received during the period that has not yet been recognized as revenue in the period due to the required revenue recognition criteria not yet being satisfied. 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.

Looking Forward

The Company continues to improve and expand its products and services, develop its sales network around the world, and improve its delivery capacity and productivity.

During the first quarter, the Company continued to witness the weakness in capital expenditures across the international aviation industry which resulted in customer payment or shipment for 6 kits. This was partially offset with the addition of monthly recurring revenue from the customers acquired in the Wingspeed acquisition in the fourth quarter of 2009. Since the level of deliverables is lower for Wingspeed- serviced customers the monthly recurring revenue from those customers is lower than for afirs-serviced customers. The Company does see the potential to sell value-added services to the former Wingspeed customers as well as the opportunity to upgrade these customers to a full afirs Uptime solution over time.

In addition, the Company is introducing value-added information products and specialty services that can build customer value and AMA revenues from existing installations as well as new ones. Three areas of concentration have been the addition of essential flight data recorder data streaming, fuel management program and related product enhancements, and fee-for-service consulting services. The Company views these initiatives as enhancing the value added to the industry and as strengthening the monthly recurring revenue base.

Various strategic relationships with leading organizations leverage our marketing capability world wide. These organizations have completed their due diligence on AMA's product and service capabilities. The teaming and seller agreement with L-3 Communications ("L-3") gives AMA access to the sales network of the industry-leading manufacturer of flight data recorders (black boxes). The L-3 agreement will allow AMA and L-3 to market and sell a bundled solution to the airline industry and AMA will be the exclusive provider to L-3 of Iridium based real- time solutions. The license and manufacturing agreement with Sierra Nevada Corporation ("SNC") gives SNC the right to manufacture the Company's afirs product and market the afirs UpTime technology and products to the global military market. These agreements, in addition to AMA's continuing strategic relationship with Meggitt plc (MGGT:L), provides AMA with a higher standard of credibility within the global aviation community and with access to prime contracts and airframe manufacturers.

Results of Operations – Three Months Ended March 31, 2010

Revenue

As shown in the Summary of Quarterly Results Table, the afirs and UpTime revenue as well as other revenue consisting of consulting services, license fees, and interest revenue are producing the results forecasted. The Company's long term investment in marketing and relationship building has given the Company a strong pipeline of prospective clients around the world. The ongoing revenue streams from our existing client base is expected to continue to expand throughout this and future years. The installation delays associated with customers' decisions to install afirs during heavy maintenance continue to delay revenue recognition, but they represent captive long-term recurring revenue.

The Company has two types of revenue streams relating to afirs equipment depending on the type of service agreement: (1) rental and (2) 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. In the early stages of the Company's growth, this will result in less recognized revenue than cash received. For sales type agreements, afirs fees are deferred as unearned revenue and corresponding expenses are recorded as work in progress. When the system is fully functional and the customer has accepted the system, the deferred amount is fully recognized in revenue along with the work in progress as cost of sales. Under both forms of agreement, the UpTime usage fees are recognized as the service is provided based on actual customer usage that month. For the Sierra Nevada Corporation ("SNC") license fee, the amount received is deferred as unearned revenue and revenue is recognized over the initial 5 year term of the agreement.

AMA received \$1,338,670 in cash revenues in the quarter with \$1,112,876 reported as revenue and \$225,794 being included in unearned revenue, which compares to \$2,828,469 in cash revenue in the first quarter of 2009 with \$1,253,932 reported as revenue and \$1,574,537 being included in unearned revenue. The decrease in cash revenue was primarily due to the SNC cash license fee of \$1,287,600 that was received in the first quarter of 2009 as well as a lower level of shipments.

Revenue decreased \$141,056 in the first quarter compared to the first quarter of last year. afirs UpTime revenues increased by \$98,680 over the first quarter of 2009 as the result of increased monthly recurring revenue, recognition of sales type agreements, and the addition of monthly revenues from former Wingspeed customers. Product sales revenue decreased by \$145,507 as the result of decreased sales of Under Floor Stowage Units when compared to the first three months of 2009 as a result of a decreased emphasis on the sales and marketing of the product and the concentration of efforts on AMA's core afirs UpTime product line. Services revenue and interest decreased \$94,229 over the first quarter of 2009 as the result of a lower requirement for consulting and engineering services by existing customers.

Revenue is expected to grow at a higher rate than costs because the Company has the infrastructure, sales people, and support organization in place to support revenue growth. The industry recognition of the afirs UpTime product innovation has allowed AMA to continue to be active at several leading industry events. This shows that AMA's products and services are being recognized as leading edge in this industry. In addition, the Company continues to grow its service offerings such as fuel management which increase both monthly recurring and one-time services revenue.

Cost of Sales and Gross Margins

AMA's cost of product sales includes the direct cost of the afirs kit, installation, and training support labour as well as associated travel and shipping expenses. Installations on aircraft are performed by third parties at the customer's expense. Fuel management consulting costs are primarily-labour and travel-related. The percentage cost of sales in the first quarter of 2010 is 40.7% compared to 48.5% in 2009. This decrease is due to the fluctuation between quarters in the mix of revenue coupled with the change to sales type agreements. As well, increased recurring revenue as a percentage of total revenue during the quarter will decrease cost of sales as a percentage of total revenue since the cost of sales for recurring revenue is lower than that for afirs shipments and its corresponding non-routable supplies and support.

The gross margin comparison for the past eight quarters is 59.3% for Q1 2010 compared to 64.6% for Q4 2009, 45.6% for Q3 2009, 65.8% for Q2 2009, 51.5% for Q1 2009, 38.1% for Q4 2008, 67.9% for Q3 2008 and negative gross margin of 19.5% for Q2 2008.

Net Loss, General Administrative and Marketing Expenses

The net loss in the quarter ending March 31, 2010 was \$2,068,591 compared to a loss of \$1,299,036 in the same quarter of 2009, which is an increase of \$769,555. This increase is primarily due to decreased sales of \$141,056 coupled with increased salaries and benefits of \$181,949, decreased general and administrative expenses of \$163,176, increased research and development of \$609,007 and increased bad debt expense of \$129,037. If the direct costs associated with the development of the next generation afirs 228 was removed the loss for the first quarter of 2010 would be \$1,259,988 or a decrease of \$39,048 compared to the first quarter of 2009.

Marketing expenses increased by \$26,473 to \$137,896 over the first quarter in 2009. These figures do not include salaries, and are indicative of the focus of the sales and marketing team on the use of technology to meet the needs of potential customers while minimizing the costs associated with marketing to the global aviation industry. As well the addition of agents in key markets has reduced the need for North American based sales personnel to travel as extensively. We expect that expenses in marketing will remain the same or increase into the future as the Company's focus is on generating new customers. The promotion of the product line to potential customers benefits from face to face meetings to build confidence of, and relationship with, future customers which creates the need for travel for senior staff to close the agreement. As the aviation industry rebounds and the demand for the Company's products and services increases, there is an anticipation that marketing costs will increase.

Salaries continue to be the main cost of doing business for AMA. We provide sophisticated technical products and services that our customers rely on for timely support of their fleets. A highly-qualified and motivated staff, scaled to the size of the customer base, is essential in meeting these expectations and achieving a reputation of dependability in the industry to facilitate our growth. The Company maintains staffing levels to meet these objectives. As a result of corporate objectives, opportunities and the development of the afirs 228, salaries and benefits increased by \$181,949 from \$1,090,133 in the first quarter of 2009 to \$1,272,082 in the first quarter of 2010.

Stock based compensation in the first quarter of 2010 was \$11,219 versus \$nil in the corresponding period of 2009 due to stock options being issued in the first quarter of 2010 and the revaluation of unvested stock options on consultant options that did not occur in the first quarter of 2009.

Bad debt expense increased \$129,037 from the first quarter of 2009 as the result of management's assessment of the collectability of accounts.

General and administrative expenses decreased by \$163,176 to \$335,413 compared to \$498,589 in the first quarter of 2009 due to the reduction of legal expenses related to legal actions that AMA was defending in 2009.

Research and Development

Research and development costs for the first quarter of 2010 were \$808,603 as compared to \$199,596 in 2009, an increase of \$609,007. The increase during the quarter is the result of the full scale commencement of the development of the next generation afirs product (afirs 228) in collaboration with SNC. It is anticipated that this level of development will continue throughout 2010 and 2011. The majority of these costs are consulting, testing, certification, and other expenses.

Foreign Exchange

The Company is susceptible to foreign exchange fluctuations resulting from the significant portion of its revenues being generated in U.S. dollars. The strength of the Canadian dollar, and the fact that a majority of the Company's accounts receivable are denominated in United States dollars, would have resulted in foreign exchange losses but purchases of U.S. dollar denominated services and supplies offsets these losses creating a foreign exchange gain of \$21,569 in the first quarter of 2010 as compared to foreign exchange loss of \$2,717 for the same period in 2009.

Summary of Quarterly Results

	Q2-08	Q3-08	Q4-08	Q1-09	Q2-09	Q3-09	Q4-09	Q1-10
Revenue (cash)	\$ 1,210,833	\$ 1,498,481	\$ 1,934,462	\$ 2,828,469	\$ 2,783,947	\$ 1,133,796	\$ 725,565	\$ 1,338,670
Revenue (GAAP)	596,263	789,994	1,392,671	1,253,932	1,324,004	1,521,894	1,006,664	1,112,876
Loss	2,709,237	1,814,010	1,912,469	1,299,036	1,333,969	717,268	1,189,445	2,068,591
Loss/Share	\$ 0.03	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.02

Liquidity and Capital Resources

At March 31, 2010 the Company had working capital of \$5,237,572 compared to a working capital of \$7,572,447 at December 31, 2009 a decrease of \$2,334,875. The decrease in the working capital is attributed primarily to a decrease in cash of \$1,308,930 decreased accounts receivable of \$9,372, decreased prepaid and deposits of \$121,388, decreased inventory of \$50,426, increased accounts payable of \$697,784 an increase in the current portion of unearned revenue of \$136,928, an increase in the current portion of loans payable of \$11,595 and a decrease in the current portion of obligation under capital leases of \$1,548.

The payables at March 31, 2010 include customer deposits totaling \$587,770 compared to \$623,984 at December 31, 2009, a decrease of \$36,214. As well, the current portion of unearned revenue increased \$136,928 to \$1,726,241 at March 31, 2010. Neither the customer deposits nor current portion of unearned revenue are refundable and if they were not included in the working capital calculation, the resulting modified working capital at March 31, 2010 would be \$7,551,583 compared to \$9,785,744 at December 31, 2009, an decrease of \$2,234,161.

The Company's ability to continue is dependent upon attaining and sustaining profitable operations and obtaining additional financing in order to fund its working capital requirements and on-going operations. The Company's ability to attain profitable operations and positive cash flow in the future is dependent upon various factors, including its ability to acquire new customer contracts, the success of management's continued cost controls and general economic conditions.

The Company currently has no bank debt and has an operating line of \$250,000 which as at March 31, 2010 was at a nil balance. The operating line bears interest at Canadian chartered bank prime plus 1.5%, and is secured by assignment of cash collateral and a general security agreement.

Contingencies

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

In September 2007, the Company among others was served with a counterclaim alleging that the Company induced a breach of contract and interfered with economic relationships. The Company maintains that the claims are without merit and no liability has been included in these consolidated interim statements, as management intends to vigorously defend the matter and believes the outcome will be in its favour. On November 7, 2007 the Company filed a Statement of Defense and a counterclaim against three parties for their interference with legally binding contracts, disrupted business, attacks on the Company's reputation, and costs. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable. The Company's legal counsel has been unsuccessful in attempts to complete the discovery process.

Commitments

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

Year	Premises	Equipment	Total
2010	316,343	88,522	404,865
2011	432,652	90,328	522,980
2012	445,685	32,319	478,004
2013	458,718		458,718
2014	76,815		76,815
	\$ 1,730,213	\$ 211,169	\$ 1,941,382

IFRS Changeover Plans

International Financial Reporting Standards (“IFRS”) are to be implemented by the Company on January 1st, 2011 and CSA Notice 522-320 requires that progress on IFRS changeover plans be disclosed. AMA has completed a formal gap analysis of the differences between IRFS and Canadian GAAP. This analysis was reviewed by both the Audit Committee and external advisors. Based on that analysis the Company continues to prepare white papers on areas of significant differences based on the detailed review that has been completed. To date, AMA has indentified the following areas where differences will occur but has not yet determined the potential impact on its financial statements. These areas are:

1. Property Plant & Equipment

The decision to adopt the cost model instead of revaluation will probably be made. Current depreciation rates have been reviewed and will most likely be deemed appropriate for all property, plant and equipment.

2. Impairment

IFRS results in increased exposure to impairment write downs. The movement from the existing afirs 220 to afirs 228 may result in impairment depending on the demand level for the afirs 220 at the time of transition. The Company has determined that it has a limited number of cost generating units (“CGU”).

3. Leases

The Company has determined that there is no effect on the classification of capital versus operating leases.

4. IFRS 1

The most significant item under IFRS 1 will be determining the opening values for Property.

Forward-Looking Statements

This discussion includes certain statements that may be deemed “forward-looking statements” that are subject to risks and uncertainty. All statements, other than statements of historical facts included in this discussion, including, without limitation, those regarding the Company’s financial position, business strategy, projected costs, future plans, projected revenues, objectives of management for future operations, the Company’s ability to meet any repayment obligations, the use of non-GAAP financial measures, trends in the airline industry, the global financial outlook, expanding markets, research and development of next generation products and any government assistance in financing such developments, foreign exchange rate outlooks, new revenue streams and sales projections, cost increases as related to marketing, research and development, administration expenses, and litigation matters, may be or include forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on a number of reasonable assumptions regarding the Canadian, U.S., and global economic environments, local and foreign government policies/regulations and actions and assumptions made based upon discussions to date with the

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

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

Auditors' Involvement

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

The auditors of AeroMechanical Services Ltd. have not performed a review of the unaudited interim financial statements for the three month periods ended March 31, 2010 and March 31, 2009.

Consolidated Balance Sheet

(UNAUDITED)

	March 31 2010	December 31 2009
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 5,852,497	\$ 7,161,427
Restricted cash	250,000	250,000
Accounts receivable	520,497	529,869
Deposits and prepaid expenses	166,789	288,177
Inventory	2,367,949	2,418,375
	9,157,732	10,647,848
PROPERTY AND EQUIPMENT	442,292	478,968
RENTAL ASSETS	162,691	143,539
INTANGIBLE ASSETS	443,754	478,403
	\$ 10,206,469	\$ 11,748,758
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 1,968,532	\$ 1,270,748
Current portion unearned revenue - Note 3	1,726,241	1,589,313
Current portion of loans payable	121,131	109,536
Current portion of obligation under capital lease	104,256	105,804
	3,920,160	3,075,401
UNEARNED REVENUE – Note 3	1,230,026	1,534,529
LOANS PAYABLE	180,128	202,896
OBLIGATION UNDER CAPITAL LEASE	93,384	118,147
	5,423,698	4,930,973
SHAREHOLDERS' EQUITY		
SHARE CAPITAL – Note 4	35,586,822	35,550,028
WARRANTS – Note 4	2,729,314	4,181,685
CONTRIBUTED SURPLUS – Note 4	3,393,063	1,943,917
ACCUMULATED OTHER COMPREHENSIVE INCOME	8	-
DEFICIT	(36,926,436)	(34,857,845)
	4,782,771	6,817,785
	\$ 10,206,469	\$ 11,748,758

Consolidated Statements of Loss and Deficit

(UNAUDITED)

	For the three months ended March 31, 2010	For the three months ended March 31, 2009
REVENUE		
afirs UpTime revenue	\$ 1,003,483	\$ 904,803
Product sales revenue	27,097	172,604
Services revenue	82,296	176,525
	<u>1,112,876</u>	<u>1,253,932</u>
COST OF SALES	<u>453,437</u>	<u>608,475</u>
GROSS MARGIN	<u>659,439</u>	<u>645,457</u>
EXPENSES		
Salaries and benefits	1,272,082	1,090,133
General and administrative	335,413	498,589
Research and development	808,603	199,596
Marketing	137,896	111,423
Bad debt	129,037	-
Amortization	44,779	30,448
Stock based compensation	11,219	-
Interest and bank charges	10,570	9,455
Foreign exchange currency gain	(21,569)	2,717
	<u>2,728,030</u>	<u>1,942,361</u>
NET LOSS FOR THE PERIOD BEFORE INCOME TAXES	(2,068,591)	(1,296,904)
Current income taxes	-	2,132
NET LOSS FOR THE PERIOD	<u>\$ (2,068,591)</u>	<u>\$ (1,299,036)</u>
DEFICIT – Beginning of the period	\$ (34,857,845)	\$ (30,318,127)
NET LOSS	<u>(2,068,591)</u>	<u>(1,299,036)</u>
DEFICIT- END OF THE PERIOD	<u>\$ (36,926,436)</u>	<u>\$ (31,617,163)</u>
NET LOSS PER SHARE – Basic and Diluted – Note 4	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>

Consolidated Statement of Comprehensive Income and Accumulated Other Comprehensive Income (UNAUDITED)

Net loss	\$ (2,068,591)
Unrealized loss on translation of US subsidiary	8
	8
Comprehensive loss	\$ (2,068,583)
Accumulated other comprehensive income, December 31, 2009	\$ -
Unrealized income on translation of US subsidiary	8
	8
Accumulated other comprehensive income, March 31, 2010	\$ 8

Consolidated Statement of Cash Flows

(UNAUDITED)

CASH PROVIDED BY (USED IN):	For the three months ended March 31, 2010	For the three months ended March 31, 2009
OPERATING ACTIVITIES		
Net loss	\$ (2,068,591)	\$ (1,299,036)
Add items not affecting cash		
Amortization	44,779	30,448
Amortization of rental assets	9,066	30,492
Amortization of intangibles	34,649	-
Write down of rental assets	-	7,200
Stock based compensation	11,219	-
Unrealized foreign exchange (gain) loss	(17,135)	60,114
	(1,986,013)	(1,170,782)
Net change in non-cash working capital balances – Note 5	700,320	1,058,935
	(1,285,693)	(111,847)
FINANCING ACTIVITIES		
Issuance of common shares and warrants	22,350	-
Repayment of capital leases	(26,311)	(8,559)
Loan repayment	(11,173)	(15,458)
	(15,134)	(24,017)
INVESTMENT ACTIVITIES		
Purchase of property and equipment	(8,103)	(119,097)
Purchase of rental assets	-	(27,360)
Proceeds on sale of rental assets	-	46,509
	(8,103)	(99,948)
Change in cash and cash equivalents	(1,308,930)	(235,812)
Cash and cash equivalents - beginning of period	7,161,427	801,404
Cash and cash equivalents - end of period	\$ 5,852,497	\$ 565,592
SUPPLEMENTAL INFORMATION		
Taxes paid	\$ -	\$ 2,132
Interest earned	6,614	72
Cash and Cash Equivalents		
Cash in bank	\$ 5,852,497	\$ 475,592
Guaranteed investment certificates	-	90,000
	\$ 5,852,497	\$ 565,592

Notes to Consolidated Financial Statements

For the Three Month Periods Ended March 31, 2010 and 2009

(UNAUDITED)

1. Significant accounting policies:

These unaudited interim Consolidated Financial Statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP) on a basis consistent with those followed in the most recent audited annual financial statements for the year ended December 31, 2009. These unaudited interim Consolidated Financial Statements do not include all note disclosures required by GAAP for annual consolidated financial statements. Accordingly, these statements should be read in conjunction with the Company's annual audited financial statements for the year ended December 31, 2009.

2. Going concern:

At March 31, 2010, the Company had working capital of \$5,237,572 (2009 - \$934,470) a deficit of \$36,926,436 (2009 - \$31,617,163), a loss from operations of \$2,068,591 (2009 - \$1,299,036) and negative cash flow from operations of \$ 1,285,693 (2009 - \$111,847).

The Company's ability to continue as a going concern is dependent upon attaining and sustaining profitable operations and/or obtaining additional financing in order 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 containments and general economic conditions.

There is no assurance that the Company will be successful in attaining and sustaining profitable operations and cash flows or raising additional capital to meets 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 could be adversely affected. These 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 balance sheet items.

3. Unearned revenue:

Balance December 31, 2009	\$ 3,123,842
Installation access fees	237,521
License fees	(64,380)
Earned revenues	(340,716)
Balance March 31, 2010	2,956,267
Less current portion	(1,726,241)
	\$ 1,230,026

4. Share capital:

Authorized: Unlimited number of: Common shares Class A, B, and C preferred shares, issuable in series. The preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions, and conditions attached to the shares of each series.

ISSUED:

a) Common shares

	Number of Shares		Value
Balance December 31, 2009	103,498,386	\$	35,550,028
Exercise of employee options	84,000		22,350
Contributed surplus from the exercise of employee options			14,444
Balance March 31, 2010	103,582,386	\$	35,586,822

b) Stock Option Plan

	Number of Shares		Weighted Average Exercise Price
Outstanding December 31, 2009	2,784,496	\$	0.42
Options granted	20,000		0.51
Options exercised	(84,000)		0.27
Outstanding March 31, 2010	2,720,496	\$.43
Exercisable March 31, 2010	2,645,496	\$	0.43

c) Contributed Surplus

Balance December 31, 2009	\$	1,943,917
Stock based compensation		11,219
Employee stock options exercised		(14,444)
Warrants expired		1,452,371
Balance March 31, 2010	\$	3,393,063

The weighted average fair market value of the options granted was \$0.35 per option. The fair value of the options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 1.63%, expected life of 2.97 years, volatility of 117% and dividend yield rate of nil.

4. Share Capital (cont'd)

d) Warrants

	Number of Warrants		Weighted Average Exercised Price
Outstanding December 31, 2009	11,527,499	\$	0.84
Warrants expired	(2,407,500)		1.30
Outstanding March 31, 2010	9,119,999	\$	0.75

The calculation of basic loss per share is based on the weighted-average number of common shares outstanding during the three months ending March 31, 2010 of 103,538,319 (2009 – 82,500,219).

5. Supplemental cash flow information:

Change in Non-Cash Working Capital

	For the three months ended March 31, 2010		For the three months ended March 31, 2009
Accounts receivable	\$ 21,289	\$	(7,642)
Deposits and prepaid expenses	126,619		24,054
Inventory	22,203		(297,405)
Accounts payable and accrued liabilities	697,784		78,032
Deferred lease inducement	-		(2,281)
Unearned revenue	(167,575)		1,264,177
	\$ 700,320	\$	1,058,935

6. Financial instruments and financial risk management:

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of these instruments. The fair value of the loans payable could not be determined as the timing of the repayment is difficult to estimate as it is dependent on future revenues.

6. Financial instruments and financial risk management (cont'd):

The nature of these instruments and the Company's operations expose the Company to the following risks:

Credit Risk

Credit risk reflects the risk that the Company may be unable to collect amounts due to the Company from customers for its services, products, or other transactions that may be entered into by the Company. The extent of the risk depends on the credit quality of the party from which the amount is due.

The Company employs established credit approval and monitoring practices to mitigate this risk, including evaluating the creditworthiness of new customers and monitoring customer payment performance. The Company also includes the ability to receive payments in advance for both services and product in its contracts with customers as well as the ability to suspend services and ongoing support. The Company establishes an allowance for doubtful accounts that corresponds to the credit risk of its customers, historical trends and economic circumstances.

During the three month period ended March 31, 2010, the Company recorded a bad debt expense of \$129,037 to reflect accounts that the Company has determined may not be collectible and has a total reserve against receivables totaling \$127,908.

The aging of the accounts receivable as at March 31, 2010 is as follows:

Current , 1 – 30 days	\$	473,306
31 – 60 days		31,699
61 – 90 days		-
Greater than 90 days		15,492
	\$	520,497

7. Contingencies:

In September 2007, the Company, among others, was served with a counterclaim alleging that the Company induced a breach of contract and interfered with economic relationships. The Company maintains that the claims are without merit. Management intends to vigorously defend the matter and believes the outcome will be in its favour. On November 7, 2007, the Company filed a statement of defense and a counterclaim against three parties for interference with legally binding contracts, disrupted business, attacks on the Company's reputation, and costs. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.