

AeroMechanical Services Ltd.

2010 Third Quarter Report

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AeroMechanical Services Ltd.



Letter to the Shareholders

To Our Shareholders,

As we continue to ride out the global recession and its impact on our sales, we are pleased to make note of significant milestones in our strategic plan that have occurred since our Q2 report.

As indicated in the Q2 letter and webcast, the past year has been a time of critical strategic investment. We are pleased to report on some key milestones achieved in Q3. First, our industry-leading data streaming capability, FLYHTStream[™], has been cited by the European industry team working on the Oceanic Position Tracking Improvement Monitoring Initiative (OPTIMI) as a promising proven technology that would be available for deployment in the period from 2012 and beyond. This increases our visibility and credibility with manufacturers and operators alike, and provides us with a unique platform for making our case. Further, we deployed FLYHTStream on several aircraft operating in China, from which we expect Chinese aviation officials to derive future policy guidance requiring use of the technology (we continue to understand and believe that afirs is the only Iridium-based voice and data technology for aircraft approved for use in China). We also submitted final patent applications in Q3 covering many aspects of the data streaming technology (as well as separate patent applications related to the afirs 228 and a unique system concept).

During Q3, we completed a successful in-service evaluation with the largest operator of business aircraft in the world, which has proven afirs UpTime's performance and reliability, and has provided the basis for a solid return on investment in the operator's business case. We are expecting publication of these results soon, and we continue to work with the operator toward a contract for full deployment of afirs UpTime, which will be tied to the availability of the afirs 228 as well as corporate approvals.

Another major milestone achieved is the receipt of our first order from an Original Equipment Manufacturer (OEM or aircraft manufacturer), Hawker Beechcraft Corporation (HBC), a leading manufacturer of business jets, popular twin turboprops, and military trainers. This was followed by an HBC press release and published comments made by Hawker Beechcraft at NBAA that HBC intends to make afirs and UpTime service a production standard in 2011. As we have indicated for several years, and as is obvious to followers of our business, making afirs standard equipment on production aircraft has been a key goal, as it provides the market with assurance of OEM support for the equipment and the data produced, relief from the cost and delay of the retrofit process, easy access to OEM information for our engineering teams, and a steady stream of shipments and a growing base of recurring revenue-producing installations.

The afirs 228 program has experienced some delays relative to the aggressive schedule we have been pursuing. These are primarily in software development and integration. The hardware components have been undergoing environmental tests with excellent results, so we do not expect

any need for major re-work when the system is fully integrated, although minor reworks are common on a new product such as the afirs 228. The work on STCs that is a companion development to the 228 itself is continuing, so that the 228 and the Supplemental Type Certificate (STC) engineering packages will come together without further delay. At this point, the effect of the delay does not put any major programs in jeopardy. We are working with our partners, including Sierra Nevada Corporation (SNC), on means to accelerate completion, and control costs. The R&D cost of the 228 is substantial and represents the major component of our expenditures. We are working with our partners and subcontractors to mitigate the cash flow impacts.

Looking at the general marketplace, we are hearing encouraging news from the airline sector in terms of load factors and improving profits. However, these load factors have come in part as a result of aircraft being taken out of service, as well as through increasing demand. Air freight performance is sluggish, reflecting the persistence of the global economic problems. In its September report, the International Air Transport Association (IATA) said the contrast between passenger and freight market performance shows, "a mixed picture for industry performance. Seasonally adjusted figures show that, compared to the previous month (August), passenger traffic expanded by 2.1% while freight markets contracted by an equal 2.1%." On the positive side, two markets where we are concentrating and achieving success, the Middle East and Africa, are cited as the fastest growing markets globally.

We had a strong corporate presence at the recent 2010 annual meeting of the National Business Aircraft Association (NBAA), attended by 25,000 delegates, where the general sense was that the hard-hit business aviation segment has stabilized and is slowly recovering. The annual report by Honeywell on Business Aviation confirmed that the previously-predicted recovery is delayed because of the slow recovery of the economy in general, slipping their prediction of a measurable start of a rebound from 2011 to 2012. However, Honeywell and the Teal Group agree that the 5-year production of new business aircraft will be in the 5,000 range (mostly post-2011) and the 10-year outlook is for 10,000 new production business aircraft. It is significant to note that the world's largest fleet operator of business aircraft, NetJets, reported profits and growth and also placed a large order for business jets from Embraer at the NBAA. As we have discussed in the past, the Business Aviation market segment presents a unique opportunity for our company as it does not have substantial infrastructure that we would need to displace, and its needs are well aligned with our afirs UpTime products and services. As such, the timing of the recovery has allowed us time to improve our positioning to capture a significant share of this large market.

The bottom line on the marketplace is that recovery continues however it is modulated by the pace of global recovery, consolidation continues, and capital spending is still limited in many cases. However, signs are that the market is getting healthier, and therefore our opportunities to close sales are improving as well.


While year-to-date revenues are running at about 85% of last year's record revenue, most of the YTD deficiency in deliveries occurred in Q3, traditionally our slowest quarter due to seasonal peaks in aircraft usage that translate into unavailability for shipment. Our backlog of afirs 220s ordered awaiting shipment opportunities is approximately 70 kits, as shipment availability continues to be one

of our greatest challenges, one that is largely outside our control. With a reduction of \$440,000 from last year's revenue, in large part due to lower shipments of afirs units, other activities during the quarter and since the end of the quarter are signaling a turnaround of this trend. During the quarter, we signed the largest single operator agreement in the company's history (other than China), and several of our current customers added aircraft (and afirs) to their fleets. These sales are for the current afirs 220 product, which continues to provide value and which we will be supporting for many years. As noted in a recent press release, our first military customer has increased its order for afirs. These sales, and the anticipation of several deals to be completed yet this year, are increasing our backlog and we are looking for corresponding strengthening financial results as we deliver and install systems.

The company has invested more than \$3.5 million to the end of Q3 plus internal salaries in excess of another \$1 million, primarily on the development of the afirs 228 product. We will continue to invest and deliver this unique product to customers in 2011. That investment has driven the year-to-date losses higher than last year as we expense all R&D as the costs are incurred. These fruits of investment will be the basis for our growth in the years to come. Having had more than 7 years of experience providing solutions to customers and seeing the average amount billed per customer grow as we add high value features and services, it is interesting to note that it is reasonable to expect that we should earn between \$350,000 to \$500,000 of top line revenue per aircraft over the service life of each aircraft. With that frame of reference, it is an interesting exercise to consider the inherent value created by our current delivered base (233) and unshipped backlog (70 excluding China and HBC). We feel that our share price has been unduly penalized by the affects of the global slowdown while we complete the 228 developments, and we are confident that as we add customers, OEMs, and products and services, there should be healthy growth in our stock value.

We want to thank our staff for their continued efforts and the support of our shareholders during these trying economic times; we also gratefully acknowledge the support of our customers and their help in expanding our products and services to better meet the industry's needs.

Yours truly,



Richard E. Hayden
President

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Management Discussion & Analysis

This management discussion and analysis (“MD&A”) is as of November 16, 2010 and should be read in conjunction with the unaudited interim consolidated financial statements of AeroMechanical Services Ltd. (“AMA” or the “Company”) for the nine months ended September 30, 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 nine month period ended September 30, 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:

afirs UpTime: afirs stands for Automated Flight Information Reporting System (afirs[™]) and is a flight data recorder that automatically records aircraft operational parameters, compiles and interprets the data, and sends summary information to UpTime[™], the server on the ground anywhere, anytime, in real-time.

FLYHT Fuel Management System: a tool that allows key decision makers to efficiently manage and understand fuel usage within their airline operation.

FIRST: the Fuel Initiative Reporting System Tracker (FIRST[™]) can work as part of or separately from the FLYHT Fuel Management System to help airlines measure and manage fuel usage.

FLYHTStream[™]: an emergency data streaming mode that streams real-time data to the ground to be analyzed immediately.

aeroQ[™]: a cabin cleaning system that is designed to reduce the risk of infection from surfaces in passenger aircraft due to biofilm infestations.

Underfloor Stowage Unit: offers the flight crew additional stowage space in the cockpit for manuals and safety equipment that they can reach throughout the flight.

These products and services are marketed and supported globally by a team of several employees and agents based in Canada (Calgary and Ottawa), United States (Boston, Atlanta and Portland), United Kingdom, Ireland, France, Switzerland, India, United Arab Emirates 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, loss before R & D and cash revenue. AMA defines working capital as

current assets less current liabilities. The Company defines modified working capital as current assets less current liabilities not including customer deposits or the current portion of unearned revenue. 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. Loss before R & D is defined as the net loss minus the direct costs associated with research and development but does not include internal labour costs. 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 third quarter, the Company witnessed signs of a modest increase in capital expenditures across the international aviation industry, which resulted in customer payment or shipment of 6 kits. At the end of the third quarter AMA had a backlog of pending shipments or units not yet activated of 126 excluding units contracted by its Chinese customer. During the third quarter the Company continued to negotiate with potential customers, which resulted in the execution during the quarter of two service agreements for a total of 36 aircraft with a total estimated potential revenue of USD \$4,558,360 over the five year terms of the agreements if AMA is able to install on all contracted aircraft and provide recurring services for the full term of the agreements. Since the end of the quarter, two agreements have been executed that are of great significance to the company. The Company signed its first direct agreement with an original equipment manufacturer (OEM), Hawker Beechcraft Corporation (HBC), whereby HBC will offer AMA's solution as a factory installed option and as part of that initiative has ordered and been shipped an initial kit for installation on HBC's demonstration aircraft. The second agreement was the expansion of the agreement previously signed with a Middle East military organization to add an additional 3 aircraft with total estimated potential revenue of USD \$1,494,499 over the term of the agreement if AMA is able to install on all contracted aircraft and provide recurring services for the full term of the agreements.

In addition, the Company continues to meet the needs of the aviation industry through the introduction of value-added information products and specialty services that can build customer value and AMA revenues from existing installations as well as new ones. Three areas of concentration continue to be the essential flight data recorder 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. 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 partnership agreement with GuestLogix Inc. (TSX: GXI) allows for the joint marketing and selling of their real-time credit and debit card transaction processing services to the airline industry. 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. AMA's strategic relationship with Meggitt plc (MGGT:L) is to jointly market both companies' solutions to airlines and the military. These agreements provide 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 September 30, 2010

Revenue

The Summary of Quarterly Results Table (on page 12) outlines the quarterly afirs and UpTime revenue as well as other revenue consisting of consulting services, license fees, and interest revenue. 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. 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, UpTime usage fees are recognized as the service is provided based on actual customer usage each month. For the 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 \$1,361,860 in cash revenues in the quarter with \$1,081,929 reported as revenue and \$279,931 being included in unearned revenue, which compares to \$1,133,796 in cash revenue in the third quarter of 2009 with \$1,521,894 reported as revenue and a reduction in unearned revenue of \$388,098. The decrease in cash revenue was primarily due to the lower level of paid for kits or shipments.

Revenue decreased \$439,965 in the third quarter compared to the third quarter of last year. afirs UpTime revenues decreased by \$445,330 over the third quarter of 2009 as the result of the combination of increased monthly recurring revenue being offset by a reduction in the recognition of sales type agreements, and the addition of monthly revenues from former Wingspeed customers.

Product sales revenue decreased by \$42,910 as the result of decreased sales of Under Floor Stowage Units when compared to the third quarter 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 increased \$48,275 over the third quarter of 2009. 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 have the potential to 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 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 travel-related. The percentage cost of sales in the third quarter of 2010 is 46.3% compared to 54.4% 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, the addition of Wingspeed customers in late Q4 2009 at overall lower margins increases the cost of sales as a percentage of revenue. These were partially offset by increased recurring revenue as a percentage of total revenue during the quarter that has a corresponding lower cost of sales.

The gross margin comparison for the past eight quarters is 53.7% for Q3 2010 compared to 58.3% for Q2 2010, 59.3% for Q1 2010, 64.6% for Q4 2009, 45.6% for Q3 2009, 65.8% for Q2 2009, 51.5% for Q1 2009, and 38.1% for Q4 2008.

Net Loss, General Administrative and Marketing Expenses

The net loss in the quarter ending September 30, 2010 was \$2,596,646 compared to a loss of \$717,268 in the same quarter of 2009, which is an increase of \$1,879,378. This increase is primarily due to decreased gross margin of \$114,066 coupled with increased salaries and benefits of \$164,535, increased general and administrative expenses of \$167,609, increased research and development of \$1,450,667, decreased marketing of \$7,151, decreased bad debt expense of \$26,759, increased amortization of \$10,988, decreased stock based compensation of \$14,401, decreased interest and bank charges of \$1,131, and decreased foreign exchange gain of \$21,165. If the loss in the third quarter 2010 was adjusted by the direct costs associated with research and development, including the extensive development of the next generation afirs 228, the loss would be \$1,135,458 or an increase of \$428,921 compared to the third quarter of 2009.

Marketing expenses decreased by \$7,151 over the third quarter in 2009 to \$85,471. These figures do not include salaries, and are indicative of the focus of the sales and marketing team on developing new business opportunities using both face to face communications and technology to meet the needs of potential customers while minimizing the costs associated with marketing to the global aviation industry. 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 relationships 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 \$164,535 from \$1,002,285 in the third quarter of 2009 to \$1,166,820 in the third quarter of 2010.

Stock based compensation in the third quarter of 2010 was \$4,332 versus \$18,733 in the corresponding period of 2009 due to the revaluation of unvested options in Q3 2010 versus 100,000 options granted and fully vested at a fair value of \$0.19 in the same quarter of 2009.

Bad debt expense decreased \$26,759 from the third quarter of 2009 as the result of management's assessment of the collectability of accounts.

General and administrative expenses increased by \$167,609 to \$390,243 compared to \$222,634 in the third quarter of 2009 due mainly to increased professional fees of \$128,305 related to a number of initiatives including the ongoing legal action, patent applications, IFRS conversion, and Federal Aviation Administration (FAA) liaison. The remainder is related to occupancy costs.

Research and Development

Research and development costs for the third quarter of 2010 were \$1,461,188 as compared to \$10,521 in 2009, an increase of \$1,450,667. 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 the remainder of 2010 and into early 2011 as the afirs 228 and other products are brought to market. If the direct costs associated with research and development initiatives were removed from the calculation of net loss and cash flow, the Company's net loss for the third quarter would be \$1,135,458 and the cash outflow from operations would be \$330,072. The majority of these costs are consulting, testing, certification, and other expenses and do not include internal labour costs.

Foreign Exchange

The Company generally has net positive U.S. dollar working capital and is therefore susceptible to foreign exchange fluctuations. These exchange fluctuations resulted in an overall foreign exchange loss of \$2,531 in the third quarter of 2010 as compared to foreign exchange loss of \$23,696 for the same period in 2009.

Summary of Quarterly Results

	Q4-08	Q1-09	Q2-09	Q3-09	Q4-09	Q1-10	Q2-10	Q3-10
Revenue (cash)	\$ 1,934,462	\$ 2,828,469	\$ 2,783,947	\$ 1,133,796	\$ 725,565	\$ 1,338,670	\$ 1,704,791	\$ 1,361,860
Revenue (GAAP)	1,392,671	1,253,932	1,324,004	1,521,894	1,006,664	1,112,876	1,281,147	1,081,929
Loss	1,912,469	1,299,036	1,333,969	717,268	1,189,445	2,068,591	2,548,584	2,596,646
Loss before R&D	1,654,311	1,099,440	1,103,034	706,747	1,056,053	1,259,988	1,370,475	1,135,458
Loss/Share	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.02	\$ 0.03

Results of Operations – Nine Months Ended September 30, 2010

Revenue

Revenues decreased by \$623,878 in the first nine months compared to the same period of 2009. afirs UpTime revenues decreased by \$338,646 over the same nine month period of 2009. Product sales revenues decreased by \$258,474, and license fees and interest decreased by \$26,758 compared to the corresponding nine month period of 2009. Cash revenue for the first nine months of 2010 was \$4,405,321 compared to \$6,746,212 in the same period of 2009, a decrease of \$2,340,891.

Cost of Sales and Gross Margins

Percentage Cost of Sales in the first nine months of 2010 was 42.8% of sales compared to 46.1% in the same period of 2009. This consistent cost of sales was due to a consistent level of afirs UpTime revenue during the nine month period and the ability of AMA to keep costs relatively constant. This resulted in a gross margin in the first nine months of 2010 of 57.2% versus 53.9% in the same period of 2009.

Net Loss and General Administrative and Marketing Expenses

The net loss in the nine month period ending September 30, 2010 was \$7,213,821 compared to a loss of \$3,350,273 in the same nine month period of 2009, which is an increased loss of \$3,863,548. This increase is primarily due to the decreased revenue in 2010 of \$623,878 coupled with increased research and development of \$3,099,678, increased salaries and benefits of \$503,812, increased marketing expenses of \$42,575, decreased stock-based compensation of \$79,417, increased general and administration expenses of \$21,277, increased bad debts of \$66,754 and decreased foreign exchange currency loss of \$57,498. The overall increase in expenses during the first nine months ended September 30, 2010 versus the corresponding nine month period of 2009 is primarily the result of initiatives related to the development of the afirs 228, which if the direct costs associated with those

initiatives plus other research and development were removed the net loss for the first nine months of 2010 would be \$3,673,091 versus \$2,909,221 for the same period of 2009, an increase of \$763,870. Stock based compensation decreased due to a decreased number of options being granted at reduced average fair market values as compared to 2009. The increase in bad debts is the result of the receivership of two airline customers.

Research and Development

Research and development costs for the first nine months of 2010 were \$3,540,730 as compared to \$441,052 in 2009, an increase of \$3,099,678, which is primarily the result of the initiatives related to the development of the afirs 228. There is also ongoing design, testing, and certification of afirs and UpTime to add aircraft types to its approved installation list and the addition of service offerings such as FIRST, FLYHT Fuel Management System and FLYHTStream.

Liquidity and Capital Resources

As of September 30, 2010 the Company had negative working capital of \$104,089 compared to negative working capital of \$303,458 in the same period of 2009, an increase of \$199,369. The increase in the working capital is attributed primarily to an increase in cash of \$1,711,328, decreased accounts receivable of \$122,139, decreased prepaid and deposits of \$60,656, increased inventory of \$431,829, decreased operating line of \$130,738, increased accounts payable of \$1,255,697, an increase in the current portion of unearned revenue of \$560,555, an increase in the current portion of loans payable of \$84,410, and a decrease in the current portion of obligation under capital leases of \$8,931.

The payables at September 30, 2010 include customer deposits totaling \$622,693 compared to \$695,457 in the same period of 2009, a decrease of \$72,764. As well, the current portion of unearned revenue increased \$560,555 to \$1,987,250 at September 30, 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 September 30, 2010 would be \$2,505,854 compared to \$1,818,694 in the same period of 2009, an increase of \$687,160.

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 of September 30, 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 undeterminable at this time. No liability has been accrued for claims on this action.

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

Commitments

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

Year	Premises	Equipment	Total
2010	105,448	28,800	134,248
2011	432,652	90,328	522,980
2012	445,685	32,319	478,004
2013	458,718		458,718
2014	76,815		76,815
	\$ 1,519,318	\$ 151,447	\$ 1,670,765

IFRS Changeover Plans

International Financial Reporting Standards ("IFRS") are to be implemented by the Company on January 1st, 2011 and CSA Notice 52-320 requires that progress on IFRS changeover plans be disclosed. AMA has completed the white papers on areas of significant difference, calculated the differences, and prepared the initial adjustments and opening Balance Sheet. This work has been reviewed by the Audit Committee and is in the process of being reviewed by the Company's external auditors. Note that the below noted discussion on IFRS differences is subject to final audit, The adjustments anticipated by management to date are expected to be:

1. Stock Based Compensation

Stock options issued to an employee at the service commencement date but before the legal grant date are required to be initially recognized under IFRS at the estimated fair value upon

commencement of service and subsequently adjusted to actual fair value upon the legal grant date. At the transition date AMA had two employees for which this occurred and the transition adjustment results in an increase in Contributed Surplus and an increase in the Deficit of approximately \$12,000, subject to final review during the 2010 fiscal year audit.

2. Inventory Disclosure

IFRS requires the disclosure of the amount of inventories that are to be expected to be recovered after more than twelve months from the balance sheet date. Based on the nature of AMA's inventory and purchasing requirements as at the transition date it has been determined that a portion of the inventory is not expected to turnover in the 12 month period subsequent to the transition date. The disclosure adjustment at transition date is expected to be between \$800,000 and \$1,000,000.

AMA previously identified the following areas where differences may occur and based on updated analysis believes the potential impact on its financial statements is as below:

1. Property Plant & Equipment

The decision to adopt the cost model instead of revaluation was made. Management assessed the IFRS requirement to componentize property, plant and equipment into material individual components for which different depreciation methods or rates are appropriate and determined that no further componentization is required. Current depreciation rates have been reviewed and deemed appropriate for all property, plant and equipment. First time adopters may use an optional exemption to use fair value as deemed cost upon date of transition. When this exemption is used, the deemed cost becomes the new IFRS cost basis and any accumulated depreciation recognized under Canadian GAAP prior to transition is set to zero. AMS expects not to elect to use this exemption. Subject to final audit the company believes there will be no adjustment to property, plant and equipment values.

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 forecasted demand level for the afirs 220 at the time of transition. The Company has determined that it has two cash generating units ("CGU") being the afirs units and underfloor stowage. At each reporting date, the Company will assess whether there is an indication impairment. If an indication exists, the asset's or CGU's recoverable amount will be estimated and compared to the carrying amount. An impairment loss is recognized if an asset's (CGU's) carrying amount exceeds its recoverable amount. At each reporting date, the Company will assess whether there is an indication that a previously recognized impairment loss has reversed. Although subject to final audit, the company believes there will be no impairment adjustment at transition.

3. Leases

Subject to final audit, the Company has determined that there will be no changes in the classification of capital versus operating leases from both a lessor and lessee perspective and therefore no adjustment to opening balances.

Forward-Looking Statements

This discussion includes certain statements that may be deemed “forward-looking statements” that are subject to risks and uncertainty. All statements, other than statements of historical facts included in this discussion, including, without limitation, those regarding the Company’s financial position, business strategy, projected costs, future plans, projected revenues, objectives of management for future operations, the Company’s ability to meet any repayment obligations, the use of non-GAAP financial measures, trends in the airline industry, the global financial outlook, expanding markets, research and development of next generation products and any government assistance in financing such developments, foreign exchange rate outlooks, new revenue streams and sales projections, cost increases as related to marketing, research and development (including afirs 228), administration expenses, and litigation matters, may be or include forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on a number of reasonable assumptions regarding the Canadian, U.S., and global economic environments, local and foreign government policies/regulations and actions and assumptions made based upon discussions to date with the Company’s customers and advisers, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include production rates, timing for product deliveries and installations, Canadian, U.S., and foreign government activities, volatility of the aviation market for 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 and nine month periods ended September 30, 2010 and September 30, 2009.

Consolidated Balance Sheet**(UNAUDITED)**

	<u>September 30, 2010</u>	<u>December 31, 2009</u>
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 1,711,328	\$ 7,161,427
Restricted cash	250,000	250,000
Accounts receivable	557,992	529,869
Deposits and prepaid expenses	129,340	288,177
Inventory	2,295,642	2,418,375
	<hr/> 4,944,302	10,647,848
PROPERTY AND EQUIPMENT	456,060	478,968
RENTAL ASSETS	161,763	143,539
INTANGIBLE ASSETS	375,025	478,403
	<hr/> \$ 5,937,150	\$ 11,748,758
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 2,815,984	\$ 1,270,748
Current portion unearned revenue - Note 3	1,987,250	1,589,313
Current portion of loans payable	152,442	109,536
Current portion of obligation under capital lease	92,715	105,804
	<hr/> 5,048,391	3,075,401
UNEARNED REVENUE – Note 3	808,203	1,534,529
LOANS PAYABLE	103,131	202,896
WARRANTY	10,881	-
OBLIGATION UNDER CAPITAL LEASE	51,870	118,147
OBLIGATION UNDER RENTAL LEASE	33,669	-
	<hr/> 6,056,145	4,930,973
SHAREHOLDERS' EQUITY		
SHARE CAPITAL – Note 4	35,597,678	35,550,028
WARRANTS – Note 4	2,729,314	4,181,685
CONTRIBUTED SURPLUS – Note 4	3,624,655	1,943,917
ACCUMULATED OTHER COMPREHENSIVE INCOME	1,024	-
DEFICIT	(42,071,666)	(34,857,845)
Going concern (note 2)	<hr/> (118,995)	6,817,785
Contingencies (note 7)	\$ 5,937,150	\$ 11,748,758

Consolidated Statement of Loss and Deficit

(UNAUDITED)

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
REVENUE				
afirs UpTime revenue	\$ 900,758	\$ 1,346,088	\$ 3,063,868	\$ 3,402,514
Product sales revenue	43,712	86,622	83,434	341,908
Services revenue	137,459	89,184	328,650	355,408
	1,081,929	1,521,894	3,475,952	4,099,830
COST OF SALES	501,434	827,333	1,488,910	1,888,004
GROSS MARGIN	580,495	694,561	1,987,042	2,211,826
EXPENSES				
Salaries and benefits	1,166,820	1,002,285	3,622,287	3,118,475
General and administrative	390,243	222,634	1,157,257	1,135,980
Research and development	1,461,188	10,521	3,540,730	441,052
Marketing	85,471	92,622	330,950	288,375
Bad debt	-	26,759	127,380	60,626
Amortization	61,708	50,720	156,339	117,063
Stock based compensation	4,332	18,733	246,666	326,083
Interest and bank charges	9,910	11,041	29,577	29,279
Foreign exchange currency (loss) gain	(2,531)	(23,696)	(14,674)	42,824
	3,177,141	1,411,619	9,196,512	5,559,757
NET LOSS FOR THE PERIOD BEFORE INCOME TAXES	(2,596,646)	(717,058)	(7,209,470)	(3,347,931)
Current income taxes	-	210	4,351	2,342
NET LOSS FOR THE PERIOD	\$ (2,596,646)	\$ (717,268)	\$ (7,213,821)	\$ (3,350,273)
DEFICIT – Beginning of the period	\$ (39,475,020)	\$ (32,951,132)	\$ (34,857,845)	\$ (30,318,127)
NET LOSS	(2,596,646)	(717,268)	(7,213,821)	(3,350,273)
DEFICIT- END OF THE PERIOD	\$ (42,071,666)	\$ (33,668,400)	\$ (42,071,666)	\$ (33,668,400)
NET LOSS PER SHARE – Basic and Diluted – Note 4	\$ (0.03)	\$ (0.01)	\$ (0.07)	\$ (0.04)

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

(UNAUDITED)

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
Net loss	\$ (2,596,646)	\$ (717,268)	\$ (7,213,821)	\$ (3,350,273)
Translation of US subsidiary	1,051	349	1,024	118
Comprehensive loss	\$ (2,595,595)	\$ (716,929)	\$ (7,212,797)	\$ (3,350,155)
Accumulated other comprehensive income, Beginning of period	\$ (27)	\$ (231)	\$ -	\$ -
Translation of US subsidiary	1,051	349	1,024	118
Accumulated other comprehensive income, September 30, 2010	\$ 1,024	\$ 118	\$ 1,024	\$ 118

Consolidated Statement of Cash Flows

(UNAUDITED)

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
CASH PROVIDED BY (USED IN):				
OPERATING ACTIVITIES				
Net loss	\$ (2,596,646)	\$ (717,268)	\$ (7,213,821)	\$ (3,350,273)
Add items not affecting cash				
Amortization	61,708	50,720	156,339	117,063
Amortization of rental assets	10,715	18,903	26,835	77,794
Amortization of intangibles	34,648	-	103,945	-
Write down of rental assets	-	76,089	-	83,289
Stock based compensation	4,332	18,733	246,666	326,083
Rental obligation	33,669		33,669	
Warranty expense	10,881		10,881	
Unrealized foreign exchange (gain) loss	(8,388)	(8,169)	(23,244)	118,575
	(2,449,081)	(560,992)	(6,658,730)	(2,627,469)
Net change in non-cash working capital balances – Note 5	657,821	(704,450)	1,490,827	1,509,453
	(1,791,260)	(1,265,442)	(5,167,903)	(1,118,016)
FINANCING ACTIVITIES				
Issuance of common shares and warrants	1,600	9,000	29,350	9,000
Repayment of capital leases	(26,304)	(27,312)	(79,367)	(48,420)
Operating loan proceeds	-	130,738	-	130,738
Loan repayment	(14,220)	(14,697)	(56,859)	(63,186)
	(38,924)	(97,729)	(106,876)	28,132
INVESTMENT ACTIVITIES				
Purchase of property and equipment	(50,039)	(5,637)	(133,431)	(124,734)
Purchase of rental assets	-	(67,800)	(41,321)	(288,658)
Purchase of intangibles	(568)	-	(568)	-
Proceeds on sale of rental assets	-	465,335	-	701,872
	(50,607)	391,898	(175,320)	288,480
Change in cash and cash equivalents	(1,880,791)	(775,815)	(5,450,099)	(801,404)
Cash and cash equivalents - beginning of period	3,592,119	775,815	7,161,427	801,404
Cash and cash equivalents - end of period	\$ 1,711,328	\$ -	\$ 1,711,328	\$ -

Consolidated Statement of Cash Flows (cont'd)

(UNAUDITED)

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
SUPPLEMENTAL INFORMATION				
Taxes paid	\$ -	\$ 210	\$ 4,351	\$ 2,342
Interest earned	3,271	1,443	14,421	1,713
<hr/>				
Cash and Cash Equivalents				
Cash in bank	\$ 1,711,328	\$ -	\$ 1,711,328	\$ -
<hr/>				
	\$ 1,711,328	\$ -	\$ 1,711,328	\$ -
<hr/>				

Notes to Consolidated Financial Statements

For the Three and Nine Month Periods Ended September 30, 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 September 30, 2010, the Company had working capital deficit of \$104,089 (2009 - deficit \$303,458) a deficit of \$42,071,666 (2009 - \$33,668,400), a loss from operations of \$7,213,821 (2009 - \$3,350,273) and negative cash flow from operations of \$ 5,167,903 (2009 – \$1,118,016).

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 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 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	1,043,927
License fees	(193,140)
Earned revenues	(1,179,176)
Balance September 30, 2010	2,795,453
Less current portion	(1,987,250)
	\$ 808,203

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	112,000		29,350
Contributed surplus from the exercise of employee options			18,300
Balance September 30, 2010	103,610,386	\$	35,597,678

b) Stock Option Plan

	Number of Shares		Weighted Average Exercise Price
Outstanding December 31, 2009	2,784,496	\$	0.42
Options granted	975,000		0.41
Options exercised	(112,000)		0.26
Outstanding September 30, 2010	3,647,496	\$	0.43
Exercisable September 30, 2010	3,422,496	\$	0.45

The weighted average fair market value of the options granted was \$0.28 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 2.15%, expected life of 3.44 years, volatility of 112% and dividend yield rate of nil.

c) Contributed Surplus

Balance December 31, 2009	\$	1,943,917
Stock based compensation		246,666
Employee stock options exercised		(18,300)
Warrants expired		1,452,372
Balance September 30, 2010	\$	<u>3,624,655</u>

d) Warrants

	Number of Warrants	Weighted Average Exercise Price
Outstanding December 31, 2009	11,527,499	\$ 0.84
Warrants expired	(2,407,500)	1.30
Outstanding and Exercisable September 30, 2010	<u>9,119,999</u>	<u>\$ 0.75</u>

The calculation of basic loss per share is based on the weighted-average number of common shares outstanding during the three and nine month periods ending September 30, 2010 of 103,609,082 and 103,581,617 respectively (2009 – 82,504,096 and 82,501,505 respectively).

5. Supplemental cash flow information:

Change in Non-Cash Working Capital

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
Accounts receivable	\$ 181,183	\$ (138,080)	\$ (10,107)	\$ 364,832
Deposits and prepaid expenses	17,741	(48,221)	164,041	122,383
Inventory	(13,010)	13,360	118,992	(76,002)
Accounts payable and accrued liabilities	471,466	(497,291)	1,546,290	1,693
Deferred lease inducement	-	-	-	(2,281)
Unearned revenue	441	(34,218)	(328,389)	1,098,828
	<u>\$ 657,821</u>	<u>\$ (704,450)</u>	<u>\$ 1,490,827</u>	<u>\$ 1,509,453</u>

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.

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 nine month period ended September 30, 2010, the Company recorded a bad debt expense of \$127,380 to reflect accounts that the Company has determined may not be collectible and has a total reserve against receivables totaling nil.

The aging of the accounts receivable as at September 30, 2010 is as follows:

Current , 1 – 30 days	\$	457,296
31 – 60 days		94,151
61 – 90 days		6,229
Greater than 90 days		316
	\$	<u>557,992</u>

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.

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