

AeroMechanical Services Ltd.

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2009 2nd Quarter Report

AeroMechanical Services Ltd.
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Canada

Transport Canada Approved Manufacturer 63-04

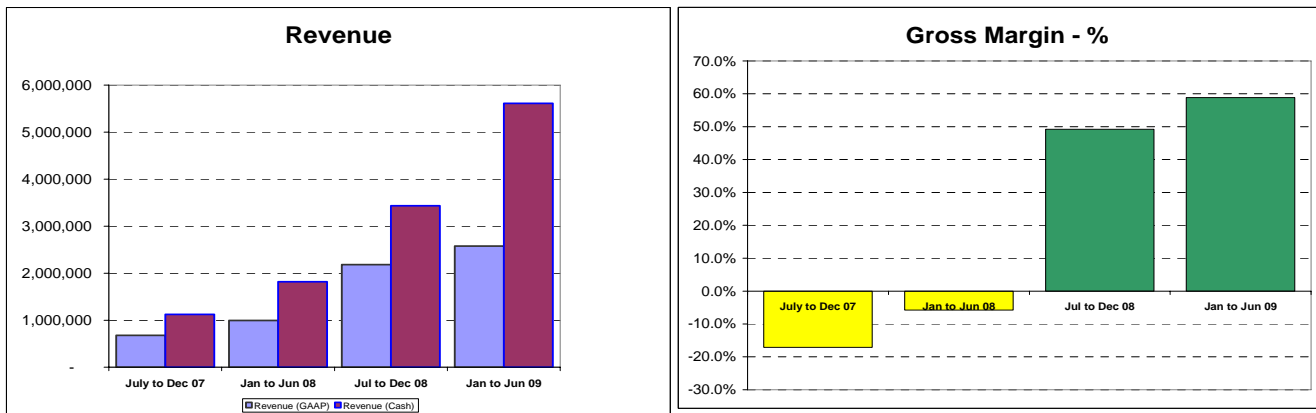
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AMA on TSX

LETTER TO THE Shareholders

Dear Shareholders,

It is no secret that airlines and air cargo operators, our primary customer base, are experiencing significant reductions in utilization and are suffering accordingly during the global recession. However, for an industry measured on revenue per available seat mile (RASM) and trying to drive profitability through reduction of expenses or cost per available seat mile (CASM), our tools and technologies provide a unique combination to support our customers as they move toward incorporating new practices and tools to realize greater productivity of their assets. We believe that it is evident in our performance that our business model is working for our customers. We continue to see growth in the business with Q2 cash revenues nearly equal to our Q1 cash revenues that included a large one time license fee payment. Our cash revenue of \$5.7 million in the first 6 months of 2009 exceeded our total 2008 cash revenues of \$5.2 million by \$421,000. We are working to continue this trend by executing strategic opportunities and adapting our product to new requirements. Note that the Q2 revenue included a shipment to a military customer doing upgrades of 20 aircraft cockpits which will take several years to complete, so the lag between shipped product and recurring revenue will be longer than usual in that case. Looking ahead, Q3 is always a slow quarter for shipments due to traditional holiday periods, flight hours are often up for the same reason. We do, however, expect to continue to book and ship in Q3.



As you will see in our management discussion and analysis for the second quarter, our working capital is not where we would all like to see it and we are implementing strict controls to manage within our means. The reduction in accounts receivable by \$630,000 from the end of 2008, is a reflection in large part of our customers paying on time and satisfactory resolution of some outstanding issues. This indicates to management that we have happy customers who need our services and are paying on time because they are receiving good product and, more importantly, good service.

We receive questions about how revenue is recognized, and referencing the Company’s revenue recognition policy in the December 31, 2008 audited financial statements. Simply put, we collect cash from customers when we ship an afirs kit, but we do not record revenue under generally accepted accounting principles (“GAAP”) until the afirs unit is installed by the customer and operational. The payments that are always received before shipment are final and not-refundable. Obviously, the recurring revenue does not start until the customer installs the system and puts it into service. To try to clarify this issue, we have therefore created a new category, Modified Working Capital as defined in our Management Discussion and Analysis, which takes these non-refundable current liabilities out of the standard working capital calculation. The results show that rather than having a working capital deficiency of about \$36k, we have an available modified working capital of \$2.6 million. It is important to note that cash received from customers who have taken delivery of the products but have not yet started using those products is listed as liabilities in our financial statements. Once the products are installed and activated, these dollars move from liabilities to revenue.

I am pleased to announce that Bill Peltola, an accomplished aviation industry sales and marketing professional, has joined our team to lead sales and marketing for AMA. Bill has an exceptional record of introducing aircraft communications products and building small innovative companies into major players in bigger markets. He is a pilot and from a unique and distinguished aviation family and we look forward to his contributions and leadership.

As you may have been reading in various media outlets, the issue of capturing data from an aircraft in distress has received significant attention, as has AMA’s patented capability to deliver this service to the industry today. Our basic afirs patent and product has the inherent ability to be launched into this mode. We are building on this foundation and some previous experience to re-launch a major initiative to satisfy this need. Interest is very high from our customer base, the aircraft manufacturers, and regulators. Our partnership with Sierra Nevada Corporation has progressed exceptionally, with some very exciting discussions with military customers, and excellent teamwork on formulating the next generation of products to respond to market opportunities.

We want to thank our shareholders for hanging on with us through some very tumultuous times and our staff for continuing to support and deliver for our customers as they navigate through some of the worst economic conditions in modern. We are proud of our growth and our ability to retain our staff and hope that our shareholders are pleased to see the first ever, positive quarterly cash flow from operating activities. We are all striving to make AeroMechanical Services Ltd. the success we all believe it can be.

Yours truly,

Richard Hayden, President



Management Discussion and Analysis

This management discussion and analysis ("MD&A") is as of August 6, 2009 and should be read in conjunction with the unaudited interim consolidated financial statements of AeroMechanical Services Ltd. ("AMA or the Company") for the three and six months ended June 30, 2009 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 and six month periods ended June 30, 2009.

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 Tracker (Fuel MIT™), Underfloor Stowage Unit, and AeroQ™. These products and services are marketed globally by a team of employees and agents based in Canada, United States, United Kingdom, France, Switzerland, Abu Dhabi 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.

The operations group continues the strides that have been made to accelerate the installations and deliverables, which will allow AMA to maximize the revenue per installed afirs unit and shorten the time from initial installation of an afirs unit to maximum revenue generation. During the second quarter, the Company has continued to build on initiatives to focus resources on customer installations and deliverables, which resulted in customer payment or shipment for 23 kits during the quarter.

In addition, the Company is introducing value-added information products and specialty services that can build customer value and AMA revenues from the 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 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 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. This agreement, 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 access to prime contracts and airframe manufacturers.

Results of Operations – Three Months Ended June 30, 2009

Revenue

As shown in the Summary of Quarterly Results Table, the afirs and UpTime revenue as well as other revenue which consists 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 will 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 represents captive long term recurring revenue.

The Company has two revenue recognition streams: (1) leases and (2) sales depending on the type of service agreements. In accordance with the Company's revenue recognition policy for lease 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



Management Discussion and Analysis

amount is fully recognized in revenue along with the work in progress as cost of sales. For the SNC license fee, the amount received is deferred as unearned revenue and revenue will be recognized over the initial 5 year term of the agreement. The amounts recorded in unearned revenue are non-refundable.

The effect in the quarter is that AMA received \$2,783,947 in cash revenues with \$1,324,004 reported as revenue and \$1,459,943 being included in unearned revenue, which compares to \$1,210,833 in cash revenue in the second quarter of 2008 with \$596,263 reported as revenue and \$614,569 being included in unearned revenue.

Revenue increased \$727,741 in the second quarter compared to the second quarter of last year. afirs Uptime revenues increased by \$825,484 over the second quarter of 2008 as the result of increased monthly recurring revenue and recognition of sales type agreements. Product sales revenue decreased by \$122,987 as the result of decreased sales of Under Floor Stowage Units when compared to the second quarter months of 2008. Services revenue and interest increased \$25,244 over the second quarter of 2008.

Revenue is expected to grow at a significantly higher rate than our costs because the Company now 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 essential flight data recorder data streaming and fuel management which will 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 customers' expense. Fuel management consulting costs are primarily labour and travel related. The percentage cost of sales in the second quarter of 2009 is 34.2% compared to 119.5% in 2008. This decrease is due to the greater absorption of costs as a result of increased paid consulting and installation services revenue, and the recognition of a portion of the SNC license fee in the second quarter of 2009, versus the same quarter of 2008. Also impacting this calculation is the revenue recognition policy, which has the effect of raising the cost of sales as installations increase. As part of our standard service, we assist new clients with engineering support on their initial aircraft installations. This cost is covered in our access fees. Additional services are paid for over and above the access fee. Non-routable parts are parts involved in the installation process that are non-reusable (such as cables) and do not form part of the rental asset as they would remain on the aircraft if the afirs unit was extracted. Travel and support costs form part of the non-routable parts and are expensed in the period. The effect is an increase in cost of sales. As we move forward with more clients and the corresponding recurring revenue streams, we will see the cost of sales continue to decline and our margins increase.

The gross margin comparison for the past four quarters is 65.8% for Q2 2009 compared to 51.5% for Q1 2009, 14.7% for Q1 2008, negative gross margin of 19.5% for Q2 2008, gross margin of 67.0% for Q3 2008 and 38.1% for Q4 2008.

Net Loss, General Administrative and Marketing Expenses

The net loss in the quarter ending June 30, 2009 was \$1,333,969 compared to a loss of \$2,709,237 in the same quarter of 2008, which is a decreased loss of \$1,375,268. This decrease is primarily due to increased sales of \$727,741 coupled with decreased cost of sales of \$260,208, decreased salaries and benefits of \$188,276, decreased marketing expenses of \$182,834, increased research and development of \$164,986, decreased stock based compensation of \$242,386 and increased bad debts of \$33,867.

Marketing expenses decreased by \$182,834 to \$84,331 over the second quarter in 2008. 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. Further 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. Our plans are to continue to attend trade shows globally that focus on marketplaces that we want our products and services to penetrate. Because our products and services are Very specialized attendance at the shows is mandatory as traditional advertising by itself does not yield significant results. The costs of these shows are relatively high because of the specific nature of these shows that are consistently held in distant locations that require long distance travel.

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 consolidation of functions and operational efficiencies, salaries and benefits decreased from \$1,214,331 in the second quarter of 2008 to \$1,026,055 in the second quarter of 2009.

Stock based compensation in the second quarter of 2009 was \$307,350 versus \$549,736 in the corresponding period of 2008 due to 1,500,000 options being granted at a fair value of \$0.205 versus 830,000 at a fair value of \$0.662 in the second quarter of 2008.

General and administrative expenses remained relatively unchanged at \$414,757 in the second quarter of 2009 compared to \$432,915 in the second quarter of 2008, a decrease of \$18,158.

All other expenses are tracking to budget as planned.

Research and Development

Research and development costs are being expensed as incurred. The second quarter development costs for 2009 were \$230,935 as compared to \$65,949 in 2008, an increase of \$164,986, which is a result of increased direct research and development activities in the quarter versus the previous year. The quarterly fluctuation is related to the Company's ongoing design, testing, and certification of afirs, and the design and testing of UpTime, FIRST, Fuel MI, and essential flight data recorder data streaming. There are also minor expenses being incurred in the preliminary phases of AeroQ™.

Management Discussion and Analysis

Foreign Exchange

All international sales of the Company's products and services are denominated in U.S. dollars. Accordingly, the Company is susceptible to foreign exchange fluctuations. 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 some of these losses resulting in a foreign exchange loss of \$63,803 in the second quarter of 2009 as compared to foreign exchange loss of \$8,256 for the same period in 2008.

Summary of Quarterly Results

	Q3-07	Q4-07	Q1-08	Q2-08	Q3-08	Q4-08	Q1-09	Q2-09
Revenue (cash)	\$ 484,738	\$ 640,941	\$ 608,842	\$ 1,210,833	\$ 1,498,481	\$ 1,934,462	\$ 2,828,469	\$ 2,783,947
Revenue (GAAP)	312,684	365,680	398,067	596,263	789,994	1,392,671	1,253,932	1,324,004
Loss	1,693,258	2,387,162	2,087,512	2,709,237	1,814,010	1,912,469	1,299,036	1,333,969
Loss/Share	\$ 0.03	\$ 0.04	\$ 0.03	\$ 0.03	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02

Results of Operations – Six Months Ended June 30, 2009**Revenue**

Revenues increased by \$1,583,606 in the first six months compared to the same period of 2008. afirs Uptime revenues increased by \$1,460,145 over the same six month period of 2008. Product sales revenues decreased by \$31,473 and license fees and interest increased by \$154,934 compared to the corresponding six month period of 2008. Cash revenue for the first six months of 2009 was \$5,612,416 compared to \$1,819,675 in the same period of 2008, an increase of \$3,792,741.

Cost of Sales and Gross Margins

Percentage Cost of Sales in the first six months of 2009 is 41.1% of sales compared to 105.8% in the same period of 2008. This decreased cost of sales is due to increased consulting services revenues which have a low cost of sales and the SNC license fee which has no associated costs. This has resulted in a gross margin in the first six months of 2009 of 58.9% versus a gross loss of 5.8% in the same period of 2008.

Net Loss, General Administrative and Marketing Expenses

The net loss in the six month period ending June 30, 2009 was \$2,633,005 compared to a loss of \$4,796,749 in the six month period of 2008, which is a decreased loss of \$2,163,744. This decrease is primarily due to the increased in revenue in 2009 coupled with decreased salaries and benefits of \$302,930, decreased marketing expenses of \$349,259, decreased stock-based compensation of \$271,086, increased research and development of \$287,852, increased bad debts of \$33,867, and increased foreign exchange currency loss of \$54,974. The overall decrease in expenses during the first six months ended June 30, 2009 versus the corresponding six month period of 2008 is the result of the increased level of installations and market acceptance of AMA's services. The decrease in salaries and benefits as well as marketing is the result of initiatives begun in 2008. Stock based compensation decreased due to an increased number of options being granted at reduced share prices. The increase in bad debts is the result of management's assessment of the collectability of accounts in excess of 90 days. While no customers have indicated that payment will not be forwarded, AMA determined that an allowance was warranted. The increase in foreign exchange loss during the six month period is the result of fluctuations in the exchange rate between the Canadian and US dollars.

Research and Development

Research and development costs for 2009 were \$430,531 as compared to \$142,679 in 2008, an increase of \$287,852, which is a result of increased direct research and development activities during the first six months of the year versus the previous year. The fluctuation is related to the Company's ongoing design, testing, and certification of afirs, the design and testing of UpTime to add aircraft types to its approved installation list and the addition of service offerings such as FIRST, Fuel MI and essential flight data recorder data streaming. This fluctuation will continue within the previous ranges as the research and development activities are adjusted to meet contractual obligations and the ongoing needs of the aviation industry. There are also minor expenses being incurred in the preliminary phases of AeroQ.

Foreign Exchange

During the six month period ended June 30, 2009, the foreign exchange loss was \$66,520 versus a foreign exchange loss of \$11,546 during the same six month period of 2008. This difference is the result of fluctuations of the exchange rate between the Canadian and US dollars during the first six months of 2009 versus the same period of 2008.



Management Discussion and Analysis

Liquidity and Capital Resources

At June 30, 2009 the Company had a working capital deficit of \$35,718 compared to a working capital of \$5,324,608 in the same period of 2008, a decrease of \$5,360,326. The decrease in the working capital is attributed primarily to a decrease in cash of \$3,344,422, decreased accounts receivable of \$114,452, decreased prepaid expenses of \$74,621, increased inventory of \$67,261, increased accounts payable of \$764,750, and an increase in the current portion of unearned revenue of \$1,108,736. The remaining decrease in working capital of \$20,606 is the result of changes in other working capital components during the quarter.

The increased payables is due to customer deposits at June 30, 2009 totaling \$1,253,516 compared to \$678,228 in the same period of 2008, an increase of \$575,288. As well, the current portion of unearned revenue increased \$1,108,736 to \$1,423,053 at June 30, 2009. 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 June 30, 2009 would be \$2,640,851 compared to \$6,317,153 in the same period of 2008.

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 June 30, 2009 was at a nil balance. The operating line bears an interest rate of Canadian chartered bank prime plus 1.0%, and is secured by assignment of cash collateral and a general security agreement.

Subsequent Events

On July 31, 2009 the board of directors approved the grant of 100,000 stock options at \$0.22 per option under the terms of the Stock Option Plan approved by the shareholders on May 22, 2009. The options vest immediately and expire one-third per year until December 31, 2012. These options were issued to the new Director of Business Development effective August 1, 2009.

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 claim on this action.

In September 2007, the Company among others were 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 attempted to complete discovery.

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:

	Premises	Equipment	Total
2009	\$ 204,379	\$ 37,095	\$ 241,474
2010	419,619	65,547	485,166
2011	432,652	36,710	469,362
2012	445,685	6,420	452,105
2013	458,718		458,718
2014	76,815		76,815
	<u>\$ 2,037,868</u>	<u>\$ 145,772</u>	<u>\$ 2,183,640</u>

In addition, the Company has repayment obligations related to two Government of Canada loan programs. Under the Industrial Research Assistance Program (IRAP), the Company has received \$277,724, which is to be repaid as a percentage of gross revenues over a five to ten year period commencing in October 2005. Under the Technology Partnerships Canada (TPC) program, the Company has received \$66,298 to be repaid over a ten year period commencing in April 2006.



Management Discussion and Analysis

Changes in Accounting Policies

Effective January 1, 2009, the Company adopted the newly issued accounting standard related to goodwill and intangible assets. The adoption of this standard had no effect on the Company's consolidated financial statements.

IFRS Changeover Plans

CSA Notice 52-320 requires that progress on IFRS changeover plans be disclosed. The Company has not yet developed a formal changeover plan but is actively educating key personnel on IFRS and the differences with Canadian GAAP. The Company engaged external advisors to assist in the initial scoping and identification of differences between IFRS and Canadian GAAP which was completed during the second quarter. The Company is using the gap analysis to develop a formal plan for changeover.

Forward-Looking Statements

Information which is contained herein contains estimates and assumptions which the Company is required to make concerning future events, and may constitute "forward-looking statements" under applicable securities laws. The forward-looking information and statements include plans, expectations, estimates, forecasts and other comments that are not statements of fact. Although such expectations are viewed as reasonable by the Company, no assurance can be given that such expectations will be realized. Such forward-looking statements are subject to risks and uncertainties and may be based on assumption that may cause actual results to differ materially from those implied herein, and therefore are expressly qualified in their entirety by this cautionary statement.

The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in such forward-looking information and statements including, without limitation: market prices; foreign exchange rates; general economic, market or business conditions in the aviation industry or any effect those may have on our customer base; changes in commodity prices; changes in the demand for or supply of the Company's products and services; unanticipated operating results; changes in tax laws or other regulatory matters; limited, unfavourable or a lack of access to capital markets; increased costs; and certain other risks detailed from time to time in the Company's public disclosure documents. The forward-looking information and statements contained in this MD&A speak only as of the date of this MD&A. The Company assumes no obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.



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 six month periods ended June 30, 2009 and 2008.

Financial Statements

**CONSOLIDATED BALANCE SHEET
(UNAUDITED)**

	June 30, 2009	December 31, 2008
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 775,815	\$ 801,404
Restricted cash	250,000	250,000
Accounts receivable	533,387	1,163,420
Prepaid expenses	141,775	312,379
Inventory	1,877,173	1,787,811
	3,578,150	4,315,014
PROPERTY AND EQUIPMENT	405,381	262,331
RENTAL ASSETS	1,265,739	1,347,508
INTANGIBLE ASSETS	34,992	34,992
	\$ 5,284,262	\$ 5,959,845
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 2,057,578	\$ 1,558,594
Current portion unearned revenue - Note 3	1,423,053	1,289,466
Current portion of deferred lease inducement	-	2,281
Current portion of loans payable	76,489	105,068
Current portion of obligation under capital lease – Note 4	56,748	24,291
	3,613,868	2,979,700
UNEARNED REVENUE – Note 3	1,812,067	812,608
LOANS PAYABLE	267,533	287,443
OBLIGATION UNDER CAPITAL LEASE – Note 4	67,866	31,134
	2,147,466	1,131,185
SHAREHOLDERS' EQUITY (DEFICIENCY)		
SHARE CAPITAL – Note 5	28,982,059	28,982,059
WARRANTS – Note 5	1,717,678	1,717,678
CONTRIBUTED SURPLUS – Note 5	1,774,700	1,467,350
ACCUMULATED OTHER COMPREHENSIVE INCOME	(377)	-
DEFICIT	(32,951,132)	(30,318,127)
	(477,072)	1,848,960
Going concern (note 2)		
Subsequent event (note 8)		
Contingencies (note 9)		
	\$ 5,284,262	\$ 5,959,845

Financial Statements

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(UNAUDITED)

	For the three months ended June 30, 2009	For the three months ended June 30, 2008	For the six months ended June 30, 2009	For the six months ended June 30, 2008
REVENUE				
Afirs UpTime revenue	\$ 1,151,623	\$ 326,139	\$ 2,056,426	\$ 596,281
Product sales revenue	82,682	205,669	255,286	286,759
Services revenue	89,699	64,455	266,224	111,290
	<u>1,324,004</u>	<u>596,263</u>	<u>2,577,936</u>	<u>994,330</u>
COST OF SALES	452,196	712,404	1,060,671	1,051,835
GROSS MARGIN	871,808	(116,141)	1,517,265	(57,505)
EXPENSES				
Salaries and benefits	1,026,055	1,214,331	2,116,189	2,419,119
General and administrative	414,757	432,915	913,346	931,152
Stock based compensation	307,350	549,736	307,350	578,436
Research and development	230,935	65,949	430,531	142,679
Marketing	84,331	267,165	195,753	545,012
Foreign exchange currency loss	63,803	8,256	66,520	11,546
Amortization	35,895	40,495	66,343	78,349
Bad debts	33,867	-	33,867	-
Interest and bank charges	8,784	14,249	18,239	23,403
Loss on asset disposal	-	-	-	9,548
	<u>2,205,777</u>	<u>2,593,096</u>	<u>4,148,138</u>	<u>4,739,244</u>
NET LOSS FOR THE PERIOD BEFORE INCOME TAXES	(1,333,969)	(2,709,237)	(2,630,873)	(4,796,749)
Current income taxes	-	-	2,132	-
NET LOSS FOR THE PERIOD	\$ (1,333,969)	\$ (2,709,237)	\$ (2,633,005)	\$ (4,796,749)
DEFICIT – Beginning of the period	\$ (31,617,163)	\$ (23,882,411)	\$ (30,318,127)	\$ (21,794,899)
NET LOSS	(1,333,969)	(2,709,237)	(2,633,005)	(4,796,749)
DEFICIT- END OF THE PERIOD	\$ (32,951,132)	\$ (26,591,648)	\$ (32,951,132)	\$ (26,591,648)
NET LOSS PER SHARE – Basic and Diluted – Note 5	\$ (0.02)	\$ (0.03)	\$ (0.03)	\$ (0.06)

Financial Statements

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
AND ACCUMULATED OTHER COMPREHENSIVE INCOME
(UNAUDITED)**

	For the three months ended June 30, 2009	For the three months ended June 30, 2008	For the six months ended June 30, 2009	For the six months ended June 30, 2008
Net loss	(1,333,969)	-	\$ (2,633,005)	-
Unrealized loss on translation of US subsidiary	(146)	-	(377)	-
Comprehensive loss	\$ (1,334,115)	\$ -	\$ (2,633,382)	\$ -
Accumulated other comprehensive loss – Beginning of period	\$ (231)	\$ -	\$ -	\$ -
Unrealized loss on translation of US subsidiary	(146)	-	(377)	-
Accumulated other comprehensive loss – End of period	\$ (377)	\$ -	\$ (377)	\$ -

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CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	For the three months ended June 30, 2009	For the three months ended June 30, 2008	For the six months ended June 30, 2009	For the six months ended June 30, 2008
CASH PROVIDED BY (USED IN):				
OPERATING ACTIVITIES				
Net loss	\$ (1,333,969)	\$ (2,709,237)	\$ (2,633,005)	\$ (4,796,749)
Add items not affecting cash:				
Amortization	35,895	40,495	66,343	78,349
Amortization of rental assets	28,399	30,710	58,891	61,901
Loss on disposal of property and equipment	-	-	-	9,548
Write down of rental assets	-	-	7,200	-
Stock based compensation	307,350	549,736	307,350	578,436
Warranty expense	-	(1,790)	-	219
Unrealized foreign exchange loss	66,629	-	126,743	-
	(895,696)	(2,090,086)	(2,066,478)	(4,068,656)
Net change in non-cash working capital balances – Note 6	1,154,968	1,293,019	2,213,903	804,410
	259,272	(797,067)	147,425	(3,263,886)
FINANCING ACTIVITIES				
Issuance of common shares and warrants	-	8,190	-	6,410,961
Repayment of capital leases	(12,548)	(7,957)	(21,107)	(17,838)
Share issue costs	-	2,420	-	(487,089)
Loan repayment	(33,031)	(23,791)	(48,489)	(28,851)
	(45,579)	(21,138)	(69,596)	5,878,183
INVESTMENT ACTIVITIES				
Restricted cash	-	34,500	-	34,500
Purchase of property and equipment	-	(27,317)	(119,097)	(94,236)
Proceeds on disposal of property and equipment	-	-	-	1,500
Purchase of rental assets	(193,498)	(235,338)	(220,858)	(381,511)
Proceeds on sale of rental assets	190,028	-	236,537	-
	(3,470)	(238,155)	(103,418)	(439,747)
Change in cash and cash equivalents	210,223	(1,046,360)	(25,589)	2,174,550
Cash and cash equivalents - beginning of period	565,592	5,166,597	801,404	1,945,687
	\$ 775,815	\$ 4,120,237	\$ 775,815	\$ 4,120,237
SUPPLEMENTAL INFORMATION				
Taxes paid	\$ -	\$ -	\$ 2,132	\$ -
Interest earned	270	23,627	270	52,323
Cash and Cash Equivalents				
Cash in bank	\$ 775,815	\$ 70,237	\$ 775,815	\$ 70,237
Guaranteed investment certificates	-	4,050,000	-	4,050,000
	\$ 775,815	\$ 4,120,237	\$ 775,815	\$ 4,120,237

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008
(UNAUDITED)**

NOTE 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, 2008, except as noted below. 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, 2008.

Effective January 1, 2009, the Company adopted the newly issued accounting standard for goodwill and intangible assets, relating to the method of accounting for goodwill and intangible assets and the related disclosures. The adoption of these standards had no effect on the Company's consolidated financial statements.

NOTE 2 GOING CONCERN

At June 30, 2009, the Company had a working capital deficit of \$35,718 (2008 - positive \$5,324,608) a deficit of \$32,951,132 (2008 - \$26,591,648), a loss from operations of \$2,633,005 (2008 - \$4,796,749) and cash flow from operations of \$147,425 (2008 - negative \$3,263,886).

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.

NOTE 3 UNEARNED REVENUE

Balance December 31, 2008	\$ 2,102,074
Installation access fees	869,851
License fees	1,287,600
Earned revenues	(1,024,405)
Balance June 30, 2009	3,235,120
Less current portion	(1,423,053)
	\$ 1,812,067

NOTE 4 OBLIGATIONS UNDER CAPITAL LEASE

During the three month period the Company acquired property and equipment totaling \$95,138 which was financed with a capital lease in the amount of \$90,296.

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NOTE 5 SHARE CAPITAL

Authorized: Unlimited number of: Common shares and 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

	<u>Number of Shares</u>		<u>Value</u>
Balance June 30, 2009 and December 31, 2008	82,500,219	\$	28,982,059

b) Stock Option Plan

	<u>Number of Shares</u>		<u>Weighted Average Exercise Price</u>
Balance December 31, 2008	2,308,998	\$	0.52
Options granted	1,500,000	\$	0.27
Outstanding June 30, 2009	<u>3,808,998</u>	<u>\$</u>	<u>0.42</u>
Exercisable June 30, 2009	<u>3,625,664</u>	<u>\$</u>	<u>0.32</u>

The fair value of the options granted on May 22, 2009 was \$0.23.

c) Contributed Surplus

Balance December 31, 2008	1,467,350
Stock based compensation	307,350
Balance June 30, 2009	<u>\$ 1,774,700</u>

d) Warrants

	<u>Number of Warrants</u>		<u>Weighted Average Exercised Price</u>
Outstanding June 30, 2009 and December 31, 2008	<u>2,572,500</u>	<u>\$</u>	<u>1.31</u>

The calculation of basic loss per share is based on the weighted-average number of common shares outstanding during the three and six month periods ending June 30, 2009 of 82,500,219 and 82,500,219 respectively (2008 – 82,188,801 and 79,608,838 respectively).

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NOTE 6 SUPPLEMENTAL CASH FLOW INFORMATION

Change in Non-Cash Working Capital

	For the three months ended June 30, 2009	For the three months ended June 30, 2008	For the six months ended June 30, 2009	For the six months ended June 30, 2008
Accounts receivable	\$ 510,338	\$ (66,573)	\$ 502,696	\$ (26,113)
Prepaid expenses	145,737	18,740	169,791	133,528
Inventory	208,043	221,512	(89,362)	571
Accounts payable and accrued liabilities	421,981	640,695	500,013	72,850
Deferred lease inducement	-	(3,422)	(2,281)	(6,843)
Unearned revenue	(131,131)	482,067	1,133,046	630,417
	<u>\$ 1,154,968</u>	<u>\$ 1,293,019</u>	<u>\$ 2,213,903</u>	<u>\$ 804,410</u>

NOTE 7 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 repayments are difficult to estimate as they are 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 has 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 six month period ended June 30, 2009, the Company recorded a bad debt expense of \$33,867 to reflect accounts that the Company has determined may not be collectible and has a total reserve against receivables totaling \$33,867.

The aging of the accounts receivable as at June 30, 2009 is as follows:

Current , 1 – 30 days	\$ 385,747
31 – 60 days	82,907
61 – 90 days	19,825
Greater than 90 days	44,908
	<u>\$ 533,387</u>

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NOTE 8 SUBSEQUENT EVENT

On July 31, 2009 the board of directors approved the grant of 100,000 stock options at \$0.22 per option under the terms of the Stock Option Plan approved by the shareholders on May 22, 2009. The options vest immediately and expire one-third per year until December 31, 2012. These options were issued to the new Director of Business Development, effective August 1, 2009.

NOTE 9 CONTINGENCIES

In September 2007, the Company, among others, were 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.