

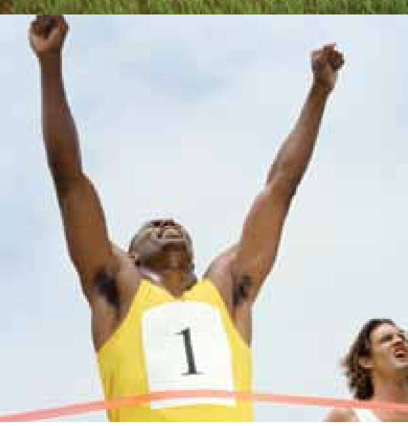



# The signals are clear

Exchange Income Corporation
annual report 2010









Exchange
Income
Corporation


PERIMETER

# Our signals are clear

In 2004, we started our operations with two straight-forward goals in mind. Grow through acquisitions. Make regular dividend payments to investors.

Over the past several years, we have done just that. And more.

We completed nine acquisitions and increased our dividend distributions six times. We have done each the hard way. Through discipline and a focus on execution.

Our growth has been steady and dependable. But after our performance in 2010, we are now ready to take our company to the next level.

- We are well capitalized with a strong balance sheet.
- We have completed investments and preparations to support two long-term Aviation segment service contracts.
- We have expanded our operations into Ontario with the addition of Bearskin Airlines.
- The manufacturing sector is gradually recovering.
- We have just completed the acquisition of Westower Communications, a company that will triple the size of our Manufacturing segment.

Combined, these developments make us ready for growth in 2011 and beyond.

The signals are clear. Very clear.

# Acquisitions are clear

Our strategy for growth centers on acquiring the right company at the right price. Our disciplined approach is very clear. If all of our criteria are not met, we move on to other targets.

9

acquisitions completed since 2004
with more to come

## Right markets

We target companies that operate in niche markets – with limited competition, strong barriers to entry, and are less susceptible to economic volatility. But most of all, we target companies that will help fuel our dividend distributions – they must have strong defensible cash flows.

## Right people

We make sure that the right people stay on after the deal closes. This results in being surrounded by knowledgeable individuals and teams that, with our financial backing, can take the target companies to a new level.

## Right space

We buy companies in sectors that we understand. This prevents us from acquiring the wrong company or entering sectors where we have limited experience or relationships.

## Right value

We never pay more than a company is worth. We base our valuation on how a target company has performed historically and not by its optimistic future growth targets. In other words, how much revenue, EBITDA and cash flows will it generate immediately for us? How accretive on a per share basis will the impact of the transaction be?

# Diversification is clear

## Aviation

| | Perimeter | Keewatin | Calm Air | Bearskin |
|---|---|---|---|---|
| **Year Acquired** | **May 2004** | **July 2005** | **April 2009** | **January 2011** |
| Assets | 29 turboprop aircrafts (up to 37 seats) | 13 turboprop aircrafts (up to 19 seats), 2 jets | 15 turboprop aircrafts (up to 68 seats) | 14 turboprop aircrafts (up to 19 seats) |
| Products/ Services | Scheduled & chartered air transportation service for passengers & cargo; air ambulance services; commercial flight training school | Medical evacuation service under the Nunavut Lifeline brand; scheduled transportation service for passengers & cargo | Scheduled & chartered air transportation service for passengers & cargo | Scheduled & chartered air transportation service for passengers & cargo |
| Markets | Remote communities in northern Manitoba, Ontario and Nunavut Territory; Provincial, Territorial, and Federal Governments | | | |
| Competitive Advantage | Adjustable aircraft for quick reconfiguration to accommodate varying numbers of passengers vs. cargo | Staffed with highly experienced medical professionals & flight crew; exclusive ownership of hangar facility at the Rankin Inlet and Iqualait airports; specially equipped aircraft for medical transport | Strong reputational franchise; fleet specially adapted for passenger & freight configuration in the Arctic; state-of-the-art hangar facility in Winnipeg, Thompson, & Churchill | Multiple flights per day into under-serviced communities in Ontario |

Our business model is based on diversification. To us the benefit is clear. It doesn't always pay to put all of your eggs in one basket. After all, most sectors experience cyclical fluctuations that impact sales, margins and profits.

We have two separate but complementary business segments – Aviation and Manufacturing.

Our model helps to limit exposure and generally provides more stability when it comes to revenue, EBITDA, earnings and dividends.

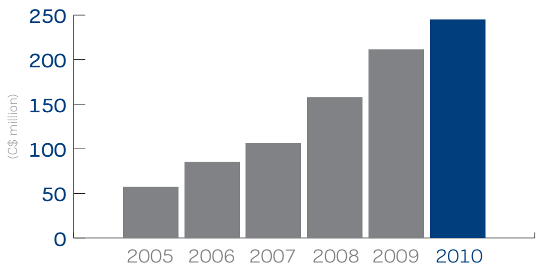
## Manufacturing

| Jasper | Overlanders | Waterblast | Stainless | Westower |
|---|---|---|---|---|
| **September 2005** | **October 2006** | **March 2007** | **January 2008** | **April 2011** |
| 40,000 sq. ft. manufacturing facility in Edmonton, Alberta | 38,000 sq. ft. manufacturing facility in Abbotsford, British Columbia | 57,000 sq. ft. manufacturing facility in Edmonton, Alberta; 6 retail locations in Alberta & British Columbia | 85,000 sq. ft. manufacturing facility in Springfield, Missouri | 53,000 sq. ft. (owned) in 6 sites; 26 (leased) locations throughout North America |
| Custom-made, high-quality steel, stainless steel, or aluminum tanks & trailers for transportation of various fluids; pressure trucks | Precision sheet metal products made from mild steel, stainless steel, aluminum, & specialty metals | Custom design & manufacture of high-pressure washer, cleaning & steam systems | Design & manufacture stainless steel tanks, vessels, & processing equipment (mixers, storage tanks, reactors, hoppers, dryers, cyclones, kilns, pressure vessels) | Custom design & manufacture towers & maintenance services |
| Oil & Gas, Municipal Water, Food & Beverage, Sewage | Gas Fireplaces, Turf/Agriculture, Telecom/Cable, Video Surveillance/Security, Restaurant, Industrial OEMs | Agriculture, Transportation, Infrastructure, Manufacturing, Construction, Truck & Automotive services, Mining, Oil & Gas | Pharmaceutical, Chemical, Food, Ethanol, Biodiesel, Dairy, Health, Cosmetics, Beverage, Drinking Water | All Telcos, Tower Holding Companies, Government & Independent Communication Companies |
| Customization: multiple pumping systems; separate water/oil pumping tubes; separate hydraulic systems | Laser inspection to ensure customer tolerances up to 0.002" are met; leading edge manufacturing system software; strong, long-term customer relationships | Exclusive dealer in Alberta & British Columbia for "Hotsy" hot & cold water pressure washer cleaning equipment used in commercial & industrial applications; strong repair & service presence supported by availability of parts | Provide in-house (up to 60,000 gallon capacity) & field (up to 600,000 gallon capacity) fabrication services; provide field repairs & modifications to existing tanks; electro-polishing to increase resistance to corrosion & bacteria | North America-wide presence; turn-key service provider; long-term relationships with telcos & tower holding companies |

# Performance is clear

## 2010 Financial Highlights

### revenue

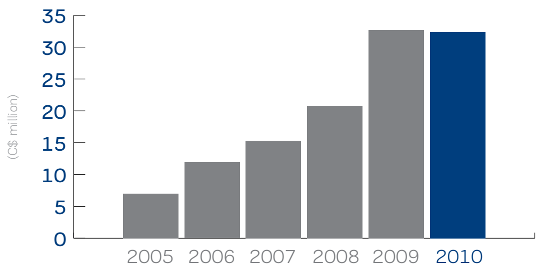



CAGR

**27.4%**

growth to $244.7 Million

### EBITDA

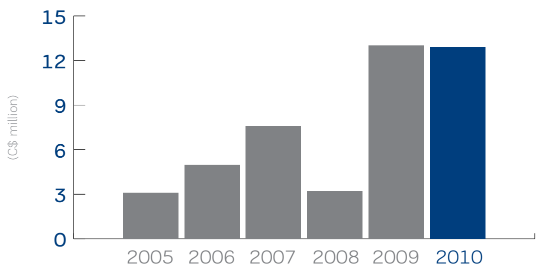



CAGR

**29.1%**

growth to $32.4 Million

### net earnings



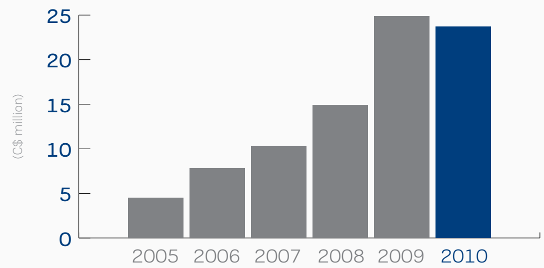

CAGR

**26.8%**

growth to $12.9 Million

# 2010 Key Performance Highlights

## distributable cash

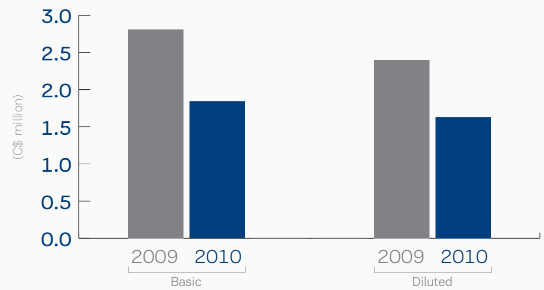



CAGR

**31.9%**

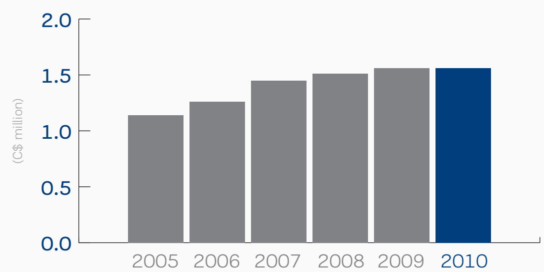
growth to $23.4 Million

## distributable cash per share




Distributable cash per share was impacted primarily by an increase in the number of common shares of more than 41% to 14.5 million shares. The increase resulted from the conversion of debentures by holders throughout 2010.

## dividends per share




CAGR

**5.4%**

growth to $1.56 per share

# The payout is clear

Unlike most income trust companies that have since converted over the past couple of years, we have maintained our basic philosophy of making regular, dependable dividend distributions to shareholders. Our business model makes it possible. We focus on EBITDA growth and we generate strong, defensible cash flows. The value for our investors is clear.

$1.56

dividend distributions per share

8.9%

yield

# 46%

total investment return

# Our growth is clear

We are effectively positioned for a breakout year in 2011. Our recent momentum makes its clear. We ended 2010 with a strong balance sheet. We also completed investments to support two major contract wins in Baffin Island and northwestern Ontario.

## Bearskin Airlines

Bearskin Airlines, a commuter airline providing passenger service in Ontario and Manitoba, was acquired in January 2011 for $32.5 million. Bearskin has been in operation for almost 50 years and offers more than 100 scheduled flights daily to 17 destinations.

The acquisition was completed to accelerate the next phase of Exchange's growth. Bearskin allows Exchange to expand into select markets in Ontario that are generally under-served, including Thunder Bay and Sioux Lookout in the northwest and Red Lake and Sudbury in the northeast.

Since the start of the New Year, we closed our acquisition of Bearskin Airlines, which expanded our Aviation segment operations into Ontario. We just completed the acquisition of Westower Communications, which will triple the size of our Manufacturing segment. We also increased our bank facility to $235 million to enable us to capitalize on new acquisition opportunities that emerge.

## Westower Communications

In April 2011, Exchange completed the expansion of its Manufacturing segment with acquisition of Westower Communications.

Founded in 1990, Westower Communications designs, builds, maintains and services wireless phone and other communications towers throughout North America. The company has 24 regional offices, three manufacturing facilities and approximately 750 employees throughout North America. The acquisition is valued at CDN $79 million.

Westower was targeted because it operates as a leader in a niche market, has a deep management team and is expected to produce results that are immediately accretive on a revenue, EBITDA, and earnings per share basis.

Demand for Westower's products and services are expected to grow in the coming years as a result of ongoing investments by telecom carriers in network and infrastructure upgrades.

# Chairman's message

2010 was a very exciting year for Exchange. We remained true to our business strategy of building shareholder value through disciplined acquisition and operation of our portfolio of companies. Our consistent approach has resulted in a 36% increase in our share price during 2010 to close the year at $17.55. The share price increase, combined with our dividend, resulted in a total return during 2010 of over 45% for our shareholders.

During the year we announced the acquisition of Bearskin Airlines, which closed on January 1, 2011. This acquisition, in combination with internal growth initiatives, such as the new medevac contract for Keewatin in the Baffin Island region of Nunavut and the Calm Air fuel delivery contract in Ontario have expanded the geographic coverage of our Aviation segment. All of these initiatives have required significant capital investment in aircraft and ground assets, and have created higher operating costs during the start-up period while building the foundation for our Aviation segment's future success. Our Aviation segment has proven to be very resilient during difficult economic times and we are excited about the growth initiatives that have been undertaken in 2010.

We are also excited to see improvement in our Manufacturing segment, particularly in the second half of the year. Our focus on managing costs during the slowdown has proven appropriate as increased sales in the second half of the year have largely flowed to the bottom line. While the economic recovery remains fragile, particularly in the United States, we look forward to continued improvement in this segment in 2011.

Our strong stock performance has assisted in de-levering our balance sheet, as approximately 2.1 million warrants were exercised and convertible debentures with a face value of $19.4 million were converted into shares. These two items increased our common shares outstanding by approximately 3.7 million and added $40 million in equity capital. While this was dilutive in the short term, it provides us the capital to grow in the future.

We completed a $30 million convertible debenture offering in April of 2010, and a second offering of $30 million was announced in December and completed in early January of 2011. This capital enabled us to close the acquisition of Bearskin Airlines, while utilizing less than 20% of our senior credit facility. We are well capitalized to continue our acquisition and organic growth programs in 2011.

We are very excited to have recently completed the acquisition of Westower Communications. It is a North American leader in the construction, installation and maintenance of wireless towers. This acquisition will triple the size of our Manufacturing segment, and is expected to be immediately accretive to our earnings and Distributable Cash per share. The strengthening of our balance sheet accomplished in 2010 will enable us to close this transaction without issuing any new equity other than the 15% of the purchase price being taken back in shares by the vendors, while maintaining our secured bank leverage well below our previously stated target of two times EBITDA.

Finally, while we had sufficient room within our current debt facility to complete the Westower transaction, it would utilize the majority of our available credit. We have therefore increased our available senior credit facility from $106 million to $235 million. This will ensure that we are well positioned to act quickly when the right opportunities present themselves. I would like to reassure our shareholders that we have not changed our view on leverage and debt levels. We intend to stay within our established targets.

On behalf of the Board of Directors, I would like to thank our shareholders for their continued support. I would also like to welcome any new shareholders that are just being introduced to our story. Hopefully our signals were clear to you that we remain committed to our business strategy of accretive acquisition and regular dividend payments to our shareholders. We will continue to perform to the highest level of fiscal responsibility as we strive to grow Exchange Income Corporation and maximize the long-term returns for our shareholders.

Gary Filmon

**Gary Filmon, P.C., O.C., O.M.**
Chairman, Board of Directors

# President's message

Since becoming a public company, we have measured our success by a number of key financial metrics, principally our ability to increase EBITDA, net earnings and Distributable Cash.

Over the years, we have made steady, incremental growth in each key metric by closely following our acquisition strategy and diversification model.

Since 2005, our growth on a compounded annual basis has been very impressive:

- Revenue has increased 27.4%
- EBITDA has grown 29.1%
- Net earnings have jumped 26.8%
- Distributable Cash has increased 31.9%

With an eye towards the future and ensuring that we sustain our growth in the years ahead, we made a series of strategic decisions in 2010. We are very focused on the long term and believe that our full potential is still ahead of us.

On a top-line basis, our successful acquisition history led to record revenue of $245 million, an increase of 16% over 2009. Our net income was down marginally (less than 1%) from 2010 at $12.8 million. EBITDA and Distributable Cash were also down marginally as the company dealt with start up and higher initial operating costs resulting from several organic growth initiatives. Keewatin was awarded a contract by the Government of Nunavut to provide medevac services to the Baffin Island region, more than doubling the portion of Nunavut that we serve. Calm Air, on the other hand, was awarded a three-year contract from Hydro One, the largest electricity transmission and distribution company in Ontario, to transport diesel fuel into remote First Nation communities in Ontario.

We believe that these new contracts will deliver significant EBITDA growth over the coming years. Unfortunately, in order to prepare these companies for delivering these services required in the new contracts, we needed to invest in new infrastructure and receive government approvals to introduce a new aircraft type, the ATR 72, into Canada. Fiscal 2011 will now see a significant growth in net revenues from these investments.

Earnings and Distributable Cash when calculated on a per share basis were down because of a significant increase in the number of shares outstanding. Our strong share price performance resulted in the conversion of debentures into shares and the exercise of outstanding warrants. While both have dramatically de-levered our balance sheet and increased our equity base, we have not yet put this capital to work generating additional EBITDA. The recently completed acquisition of Bearskin Airlines along with the acquisition of Westower Communications, as recently announced, should help correct this situation and are expected to be very accretive on a per share basis.

The acquisition of Bearskin Airlines adds to the geographic coverage of our niche aviation segment. Like Perimeter, Calm Air and Keewatin, it has a successful track record of approximately 50 years in business and we believe it is an excellent addition to this segment.

We have been very focused on managing our costs in the Manufacturing segment during the recession, but our growth in recent years has been in our Aviation segment. We are also pleased that manufacturing is making a comeback. Sales and earnings grew in our existing portfolio during the second half of the year, and the acquisition of Westower Communications will triple the size of the Manufacturing segment. Diversification has served our shareholders well over the last seven years and we believe that increasing our investment in this area will strengthen our ability to pay dividends to our shareholders.

I am very encouraged by the foundation that we have developed. Combined with recent developments, we are effectively positioned for continued growth in 2011 and beyond. We believe the signals are clear.

**Mike Pyle**
President and Chief Executive Officer

# Operational milestones

- Introduced the ATR 72, a twin turboprop passenger and freighter aircraft type, to Canada following license approval by Transport Canada. The ATR 72, which is developed and manufactured by Avions de Transport Regional in France, has been integrated into Calm Air's operating fleet.
- Keewatin Air, a subsidiary of the Corporation's Aviation segment, was awarded a five-year contract by the Nunavut Government to perform exclusive medevac services into the Baffin Island region. The contract value is anticipated to be $50 million over five years.
- Calm Air, a subsidiary of the Corporation's Aviation segment, was awarded a three-year contract by Hydro One for the hauling of diesel and bio-diesel into northern Ontario.
- Invested a total of $44.1 million in growth capital expenditures relating primarily to the acquisition of Aviation segment equipment and infrastructure to service new contracts.
- Successfully raised $30 million through the issuance of senior secured convertible debentures.
- Grew the number of common shares outstanding to 14.5 million from 10.8 million due to conversions of debentures by holders and warrants exercised.

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# Management's Discussion and Analysis

March 11, 2011

## Corporate Conversion

During the third quarter of 2009, pursuant to the plan of arrangement (the "Arrangement"), the conversion of the Exchange Industrial Income Fund ("EIIF" or "the Fund") trust structure to a corporation resulted in unitholders of the Fund receiving one common share of Exchange Income Corporation ("EIC" or "the Company") for each trust unit ("Units") held on the effective date of conversion, July 28, 2009. The Fund's convertible debentures outstanding at the effective date are now exchangeable into common shares of the Company ("Shares"). The Fund's warrants outstanding at the effective date are now exercisable into Shares of the Company. The consolidated financial statements of the Company have been prepared applying the continuity of interests method of accounting with the assets, liabilities and equity transferred from the Fund to EIC at their net book values as at the effective date of conversion. Accordingly, the comparative figures presented herein for the period prior to the effective date of the conversion are those of the Fund. As a result of the application of the continuity of interests method of accounting, certain terms such as shareholder/unitholder, dividend/distribution and share/unit may be used interchangeably throughout this discussion and analysis.

## Introduction

This Management's Discussion and Analysis ("MD&A") supplements the audited consolidated financial statements and related notes for the year ended December 31, 2010 ("Consolidated Financial Statements") of the Company. All amounts are stated in thousands of Canadian dollars, except per share or per unit data, unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This discussion has been prepared with all available information up to and including the date of this report.

In accordance with the Canadian Institute of Chartered Accountants ("CICA") Emerging Issues Committee abstract 170 – *Conversion of an Unincorporated Entity to an Incorporated Entity*, the Arrangement as described above did not constitute a change of control. Accordingly, the consolidated financial statements of the Company have been prepared applying continuity of interests accounting. For the purpose of this Management's Discussion and Analysis, the term "Company" shall denote the financial position and results of operations for the Company and the Fund, and its respective subsidiaries, for all periods presented herein.

## Forward Looking Statements

This annual report contains forward-looking statements. All statements other than statements of historical fact contained in this MD&A are forward-looking statements, including, without limitation, statements regarding the future financial position, business strategy, proposed acquisitions, budgets, litigation, projected costs and plans and objectives of or involving the Company or the businesses in which it has invested. Persons reading this MD&A can identify many of these statements by looking for words such as "believe", "expects", "will", "may", "intends", "projects", "anticipates", "plans", "estimates", "continues" and similar words or the negative thereof. Although management believes that the expectations represented in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct.

By their nature, forward-looking statements require assumptions and are subject to inherent risks and uncertainties including those discussed in this annual report. There is significant risk that predictions and other forward-looking statements will not prove to be accurate. Readers of this annual report are cautioned to not place undue reliance on forward-looking statements made or incorporated by reference herein because a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to those risk factors set out in this annual report described in Section 11 – Risk Factors of the MD&A. We caution that the list of risk factors set out herein is not exhaustive and that when relying on forward-looking statements to make decisions with respect to the Company, investors and others should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this annual report are made as of the date of this report or such other date specified in such statement.

## Non-GAAP Financial Measures

EBITDA, Distributable Cash, Free Cash Flows and Adjusted Net Earnings are not recognized measures under Canadian GAAP and are therefore defined below.

**EBITDA:** is defined as earnings before interest, income taxes, depreciation, amortization, other non-cash expenses such as unrealized foreign exchange gains or losses and asset impairment, and any unusual non-operating one-time items such as conversion costs. It is used by management to assess its consolidated results and the results of its operating segments. EBITDA is a performance measure utilized by many investors to analyze the cash available for distribution from operations before allowance for debt service, capital expenditures and income taxes. EBITDA is not a defined performance measure under GAAP and the Company's calculation of EBITDA may differ from similar calculations used by comparable entities.

**Distributable Cash:** is defined as EBITDA less cash interest, cash taxes and the capital expenditures required to maintain the operations at their current level. These sustaining capital expenditures are classed as maintenance capital expenditures. Other capital expenditures which are made to grow the enterprise and are expected to generate additional EBITDA are not included in the calculation of Distributable Cash. Distributable Cash is a performance measure used by management to summarize the funds available for the payment of dividends to shareholders in addition to GAAP's defined measures such as net income for the period.

**Free Cash Flows:** for the period is equal to cash flow from operating activities as defined by Canadian GAAP, adjusted for changes in non-cash working capital and any unusual non-operating one-time items. Free Cash Flows is a performance measure used by investors to analyze the cash generated from operations before the seasonal impact of changes in working capital items or other unusual items such as conversion costs.

**Adjusted Net Earnings:** is defined as the Net Earnings for the period after adding back the after-tax impact of the conversion costs and the non-cash impairment losses. These conversion costs are considered to be one-time expenses.

Investors are cautioned that EBITDA, Distributable Cash, Free Cash Flows and Adjusted Net Earnings should not be viewed as an alternative to measures that are recognized under Canadian GAAP such as net earnings or cash from operating activities. The Company's method of calculating EBITDA, Distributable Cash, Free Cash Flows and Adjusted Net Earnings may differ from that of other corporations or of income funds and therefore may not be comparable to measures utilized by them. A reconciliation of cash flow from operating activities to Distributable Cash and Free Cash Flows is provided in Section 3 – Key Performance Indicators of this document below.

## Additional Information

Additional information relating to the Company is on SEDAR at www.sedar.com

## 1. FINANCIAL HIGHLIGHTS

| FINANCIAL PERFORMANCE | 2010 | per share basic | per share fully diluted | 2009 | per share basic | per share fully diluted |
|---|---|---|---|---|---|---|
| For the year ended December 31 | | | | | | |
| Revenue | $ 244,694 | | | $ 211,251 | | |
| EBITDA | 32,405 | | | 32,731 | | |
| Net earnings | 12,894 | 1.00 | 0.97 | 12,989 | 1.47 | 1.39 |
| Free cash flows | 27,360 | 2.12 | 1.84 | 27,706 | 3.14 | 2.65 |
| Distributable cash | 23,736 | 1.84 | 1.63 | 24,867 | 2.81 | 2.40 |
| Dividends/distributions declared | 20,342 | 1.56 | | 14,060 | 1.56 | |
| FINANCIAL POSITION | December 31, 2010 | | | December 31, 2009 | | |
| Working capital(1) | $ 48,823 | | | $ 5,458 | | |
| Capital assets | 158,439 | | | 119,400 | | |
| Total assets | 337,007 | | | 267,809 | | |
| Senior debt(1) | 53,100 | | | 28,390 | | |
| Equity | 142,848 | | | 107,302 | | |
| SHARE INFORMATION | December 31, 2010 | | | December 31, 2009 | | |
| Common shares outstanding | 14,518,842 | | | 10,780,704 | | |

(1) The Company drew $27.6 million to fund the purchase of Bearskin Airlines on January 1, 2011. As at December 31, 2010 this amount is included in long-term debt and as restricted cash in current assets.

## 2. OVERVIEW

**Exchange Income Corporation**

The Company is a diversified, acquisition-oriented corporation focused on opportunities in the Manufacturing and Aviation segments, in particular businesses that are suited for public markets, except, in certain circumstances, for their size. The business plan of the Company is to invest in profitable, well-established companies with strong cash flows operating in niche markets in Canada and/or the United States. The objectives of the Company are:

(i) to provide shareholders with stable and growing dividends;

(ii) to maximize share value through on-going active monitoring of its operating subsidiaries; and

(iii) to continue to acquire additional companies or businesses or interests therein in order to expand and diversify the Company's investments.

The Company's reportable business segments are strategic business units that offer different products and services. The Company has two reportable business segments: Aviation and Manufacturing:

(a) Aviation – providing scheduled airline service and emergency medical services to communities located in Manitoba, Ontario and Nunavut, including certain First Nations communities, operated by Calm Air, Keewatin, Perimeter, other aviation supporting businesses, and Bearskin Airlines that was acquired on January 1, 2011; and

(b) Manufacturing – manufacturing custom tanks for the transportation of oil and gas, at Jasper Tank; manufacturing precision sheet metal and tubular products, at Overlanders; manufacturing specialized stainless steel tanks, vessels and processing equipment, at Stainless; and manufacturing specialized heavy duty pressure washing and steam systems, at Water Blast. Water Blast is also the exclusive distributor in Alberta and British Columbia for Hotsy pressure washing cleaning equipment, which is used for a variety of light commercial and industrial applications. Subsequent to 2010, the Company announced it entered into a letter of intent to acquire Westower Communications an assembler and builder of telecommunication towers. The acquisition is expected to close in the second quarter of 2011.

The operating subsidiaries of the Company operate autonomously and maintain their individual business identities. Management of the Company continuously monitors the operating subsidiaries, and will undertake future acquisitions and divestitures as deemed beneficial to the Company.

### Internal Growth Initiatives

During the 2010 year, the Company completed several significant internal growth initiatives. These growth initiatives have come with significant capital expenditures and pre-operating costs, especially during the last half of 2010. First, Calm Air was awarded a contract with Hydro One to transport diesel fuel into remote First Nation Communities in Northwestern Ontario. The contract is three years in length and will utilize the ATR 72 aircraft, which was purchased at the end of fiscal 2009. A second ATR 72 has been purchased by the Company to support this and other operations of Calm Air. The licensing of the ATR 72 aircraft in Canada was obtained near the end of the third quarter of 2010 for the first aircraft and the plane was put into service at that time. Significant costs were incurred by Calm Air from having to utilize a less efficient aircraft type to service the contract while the Company was waiting for the appropriate licensing to be granted.

Second, Keewatin was awarded the Baffin Island region medevac contract, which more than doubles the geographic portion of Nunavut that Keewatin services. As a result of the contract, the Company has made additional significant investments and incurred capital expenditures in preparation for the commencement of this contract near the end of the fourth quarter of 2010. This included the purchase of a Learjet, multiple King Air 200 aircraft, a PC-12 aircraft and the construction of a hangar in Iqaluit in order to meet the requirements of the contract. Significant levels of pre-operating costs were also incurred by the Company in preparation for the commencement and included upfront costs of locating and training personnel to perform the specialized work of the medevac contract.

Thirdly, the production capacity at Overlanders was increased with additional manufacturing equipment as part of its precision metal operations. The equipment was purchased during the third quarter of 2010. The new equipment will increase capacity and provide some labour savings by reducing overtime costs during high demand periods like that experienced at Overlanders during 2010.

### Subsequent Acquisition – Bearskin Airlines

During 2010 the Company announced that it had signed a letter of intent to acquire the airline operations and assets of Bearskin Airlines ("Bearskin"), a privately-owned commuter airline providing passenger service in Ontario and Manitoba. Subsequent to 2010, the Company announced the completion of the acquisition on January 1, 2011. The acquisition price of $32.5 million has been funded through a combination of $27.6 million of debt financing from the Company's credit facility and the issuance of the Company's common shares worth $4.9 million to the vendors of Bearskin (314,047 shares).

The acquisition is expected to be immediately accretive to the Company's key financial metrics, including EBITDA, cash flows, earnings per share and Distributable Cash. The acquisition of Bearskin will grow the Aviation segment to expand its operations into select markets in Ontario that are generally under-served. In Northwestern Ontario this includes Thunder Bay, Sioux Lookout, Kenora, and Dryden. In Eastern Ontario this includes Ottawa, Timmins, Sudbury, Red Lake, and Waterloo. The acquisition will also complement a number of the Aviation segment's existing routes in Manitoba, providing opportunities for increased synergies and efficiencies for all of our Aviation segment subsidiaries. Consistent with the Company's traditional acquisition criteria, Bearskin was identified because it operates in defensible markets with attractive margins.

Bearskin was founded in 1963 and offers more than 100 scheduled flights daily to 17 destinations. Annual revenue generated by Bearskin in 2010 was approximately $50 million. Bearskin's bases of operations are in Sioux Lookout and Thunder Bay, Ontario and Winnipeg, Manitoba. Bearskin owns and operates 14 Fairchild Metro aircraft, each with capacity for 19 passengers. Bearskin's major hubs include Thunder Bay and Sudbury in Ontario, and Winnipeg in Manitoba.

No financial results of Bearskin are included in the Company's 2010 results.

### Acquisition Target – Westower Communications

Subsequent to 2010, the Company announced on March 9, 2011 that it signed a letter of intent to acquire the shares of Westower Communications ("Westower"), which is a manufacturing and service entity that operates throughout Canada and the United States in the wireless tower industry, mainly in the design, erection, reinforcing, maintenance and servicing of towers. The acquisition price is $79 million and will be funded through a combination of available proceeds in the Company's existing senior credit facility and Shares of the Company to the Westower vendors totaling 15% of the purchase price. Pending final due diligence and satisfaction of typical conditions, the transaction is expected to close at the beginning of the second quarter of 2011.

The acquisition is expected to be immediately accretive to the Company's key financial metrics, including EBITDA, cash flows, earnings per share and Distributable Cash. The acquisition of Westower will significantly grow the Company, specifically the Manufacturing segment's portion of EIC overall, as its 2010 annual revenues were approximately $200 million in total for its combined Canadian and

US operations. Consistent with the Company's traditional acquisition criteria, Westower was identified because it operates in a niche portion of a large industry with large barriers to entry, a solid management team and has a national presence in both Canada and the US.

The announcement of Westower resulted in the Company announcing an amendment to its senior credit facility, increasing the available facility to $235 million. The term of the credit facility was also extended another year to now mature in May 2014.

The following acquisition was made by the Company during the year ended December 31, 2009:

- April 8, 2009: The Company closed the acquisition of 100% of the shares of A. Morberg Investment Corporation, the parent company of Calm Air International Ltd. ("Calm Air"), for approximately $48.7 million. Calm Air is a regional airline carrier that provides both regularly scheduled and chartered passenger and cargo flights to 16 communities in Manitoba and Nunavut.
- The total consideration for the acquisition was approximately $48.7 million. On closing of the transaction, the Company made a preliminary payment of $43.0 million which was funded with a combination of gross proceeds from the Company's public offering that closed on April 7, 2009 and a drawdown of the Company's amended bank credit facility. The vendor also received 624,211 Shares with a value of $5.9 million. The working capital adjustment was finalized in the fourth quarter of 2009, resulting in the Company receiving a payment from the vendor of $0.4 million. The Company also assumed certain debt obligations of $7.5 million (US$6.0 million) and paid certain other debt obligations of $2.9 million.
- As part of the acquisition of Calm Air, the Company assumed debt with Credit Lyonnais in association with the financing of two aircraft that were purchased by Calm Air prior to the acquisition. The security provided are two SAAB 340B Plus aircraft within the Calm Air fleet, a spare engine, certain spare parts and a guarantee by the aircraft manufacturer. The weighted average fixed interest rate was 8.51% based on the interest rates of the remaining principal amount outstanding at the time of the acquisition. This debt had two maturities, one in 2009 and the other in 2010, both have monthly principal and interest payments. As at December 31, 2010, the remaining principal outstanding on this aircraft finance debt was nil (2009 – US $2.8 million).

## 3. KEY PERFORMANCE INDICATORS

The dividends declared by the Company to its shareholders are dependent on its cash flow from operating activities with consideration for changes in working capital requirements, investing activities and financing activities of EIC. The EBITDA, Distributable Cash and Free Cash Flows generated from operations are important performance measures that are used by management to evaluate the performance of the Company.

### EBITDA

The following reconciles net earnings before income tax to EBITDA from operations and further discussion and analysis on the EBITDA results for the years can be found in Section 4 – Analysis of Operations below.

| EBITDA | 2010 | 2009 |
|---|---|---|
| Earnings before income tax | $ 13,931 | $ 13,593 |
| Interest expense | 8,057 | 7,652 |
| Amortization of intangible assets | 1,099 | 1,417 |
| Depreciation | 9,373 | 7,913 |
| Conversion costs | – | 2,655 |
| Foreign exchange gains on debt | (55) | (1,052) |
| Impairment loss | – | 553 |
| | $ 32,405 | $ 32,731 |

### Distributable Cash

As described above, the Fund converted to a corporation (Exchange Income Corporation) near the end of July 2009. Accordingly, Distributable Cash is not a metric which is commonly utilized to measure operating performance of a public corporation. Historically Distributable Cash was the key performance indicator under the predecessor's trust structure as it summarizes the funds available to unitholders of an income fund and was used by management to evaluate the ongoing performance of the Fund. Management believes, however, that it is a term with which its equity holders are familiar and has continued with this disclosure. For this analysis, the dividends paid by the Company after the conversion to a corporation are treated consistently with the distributions paid by the Fund in the comparative period in 2009 prior to the conversion.

| DISTRIBUTABLE CASH | 2010 | 2009 |
|---|---|---|
| EBITDA | $ 32,405 | $ 32,731 |
| Interest on bank debt | 2,189 | 2,741 |
| Interest on debentures | 64 | 964 |
| Interest on convertible debentures | 4,255 | 2,057 |
| Maintenance capital expenditures | 2,161 | 2,132 |
| Cash taxes | – | (30) |
| Distributable Cash | $ 23,736 | $ 24,867 |
| Distributable cash per share | | |
| Basic | $ 1.84 | $ 2.81 |
| Fully Diluted | $ 1.63 | $ 2.40 |
| Dividends/distributions declared per share | $ 1.56 | $ 1.56 |

The Distributable Cash that the Company generated for 2010 decreased by $1.1 million or 5% to $23.7 million from $24.9 million for the comparative 2009 year. The decrease is mainly attributed to the increased cash interest paid on debt related items. During 2010 the Company's level of debt outstanding under its credit facility and the amount of convertible debentures outstanding fluctuated with the issuance of the Series H convertible debentures issued and the Company using the net proceeds from that issuance to reduce the amount outstanding under its credit facility. The cash interest paid on debt related items overall increased by $0.7 million or 13% for the year. That is a result of the Company's decision to remain liquid and keep the credit facility available. During 2010 the Company incurred unutilized credit facility charges of $0.7 million, an increase of $0.6 million from 2009. The EBITDA generated by the Company in 2010 decreased by $0.3 million or 1% and is described further below in Section 4 – Analysis of Operations. Maintenance capital expenditures are also relatively stable and are described further below.

On a per share basis Distributable Cash was $1.84 (or $1.63 fully diluted) for the 2010 year and decreased in comparison to 2009 when it was $2.81 (or $2.40 fully diluted).

The Distributable Cash per share in 2010 was reduced by a number of items which increased the number of Shares outstanding without generating a corresponding increase in Distributable Cash. The number of Shares outstanding of the Company during 2010 was significantly higher as a result of the issuance of Shares as part of the acquisition of HMY Airways relating to the conversion to a corporation in July 2009, the conversion of convertible debentures by debentureholders into Shares, and the exercise of outstanding warrants into Shares.

The Company's share base used in the basic per share calculation increased by 46% as it went from 8.8 million Shares for the 2009 year to 12.9 million Shares for the 2010 year. On the fully diluted basis, the remaining outstanding convertible debentures are higher in 2010 as a result of the combined $60.0 million of convertible debentures through the Series G and Series H issuances that act as dilution factors. The combined Series G and Series H convertible debentures added 3.0 million Shares for the diluted per share calculation for the 2010 year versus 0.6 million used in the 2009 calculation. Also contributing to the higher payout ratio for the 2010 year was a decrease in Distributable Cash as described above.

As discussed above, the per share amounts have been materially impacted by the Company's financing decisions, as well as the Company's decision to convert back to a corporation before the January 1, 2011 income trust deadline through the acquisition of HMY Airways. The acquisition of HMY Airways was funded with an equity offering of 0.9 million Shares.

The increase in shares outstanding significantly decreases the per share results, while the convertible debentures result in a higher interest expense and also impact the fully diluted per share results. These decisions will continue to impact the per share results of the Company until these funds are deployed. As at December 31, 2010, the de-leveraged balance sheet puts the Company in a position to finance a $90 million acquisition without the need for additional equity financing, but as described above the Company closed the acquisition of Bearskin subsequent to 2010, which utilized approximately $30 million. Also subsequent to 2010 the Company announced entering into a letter of intent to acquire Westower. The expected acquisition of Westower will also result in the Company's credit facility being amended to increase to $235 million of available credit and after using a portion of that available facility to make the purchase the Company would have approximately $85 million available to use for financing any other future acquisitions. Both of these acquisitions are expected to be accretive immediately to the Company's key financial metrics, including Distributable Cash, with the EBITDA and cash flows generated by those entities' operations.

### Capital Expenditures

Management characterizes capital expenditures as either maintenance capital expenditures or growth capital expenditures. Maintenance capital expenditures are those required to maintain the operations of the Company at its current level. Other capital expenditures are made to grow the enterprise and are expected to generate additional EBITDA. These other capital expenditures are classified as growth capital expenditures and are not considered by management in determining the cash flows required to sustain the current operations of the Company. The following is the breakdown between the categories for the 2010 and 2009 years.

| CAPITAL EXPENDITURES | 2010 | 2009 |
|---|---|---|
| Maintenance capital expenditures | $ 2,161 | $ 2,132 |
| Growth capital expenditures | 44,132 | 9,420 |
| | $ 46,293 | $ 11,552 |
| Per share – Basic | $ 3.59 | $ 1.31 |
| Per share – Fully Diluted | $ 2.72 | $ 1.03 |

The $2.2 million of maintenance capital expenditures that the Company invested during 2010 are primarily related to the Aviation segment which invested $1.7 million on improved safety systems on the majority of their aircraft with the addition of enhanced traffic collision avoidance systems, building maintenance related items and a spare engine purchased for Calm Air's Hawker aircraft. The Manufacturing segment invested $0.4 million and head-office invested less than $0.1 million.

The Company invested a total of $44.1 million in growth capital expenditures during 2010 on a number of significant internal growth opportunities as described above in Section 2 – Overview. Of this amount, $43.1 million was incurred in the Aviation segment and the other $1.0 million in the Manufacturing segment. Throughout 2010 the Aviation segment purchased 12 aircraft, including its second ATR 72, three ATR 42's, one Dash 8, three King Air 200's, two Metro III's, one Learjet and one PC12. The cost of the aircraft purchased totaled $32.7 million and three of the aircraft purchased were previously leased. The Aviation segment also made net growth capital expenditures totaling $6.8 million on buildings, including a new hangar, and various equipment for Keewatin's new medevac contract for the Baffin Island region that commenced on December 15, 2010. In addition to these items, the Aviation segment spent another $2.7 million on ground infrastructure, including a new cargo hangar in Thompson, another hangar at one of the serviced First Nation communities, and crew quarters in Thompson. The remaining growth capital expenditures made by the Aviation segment were on a variety of other items. The major growth capital expenditure in the Manufacturing segment during 2010 is the new press brake for Overlanders described above in Section 2 – Overview.

One of the two ATR 72 aircraft in Calm Air's fleet was put into service near the end of the third quarter of 2010 and the second is awaiting an overhaul to allow for a cargo configuration before being put into service, which is expected to happen during the second quarter of 2011. The two King Air 200 aircraft, the Learjet, the PC12 aircraft and the new Iqaluit hangar were put into service in the middle of December 2010 with the start of the new Baffin Island region medevac contract for Keewatin.

### Free Cash Flows

Free Cash Flows generated from operations is used by management to assess its primary sources and uses of cash flow and to assess the Company's ability to sustain its dividend policy. Free Cash Flows for the period is equal to cash flow from operating activities as defined by Canadian GAAP, adjusted for changes in non-cash working capital and any unusual non-operating one-time items. Due to the seasonal fluctuation of certain non-cash working capital items and the limited impact those items have on determining the cash flows available to be paid to shareholders of the Company, the change in non-cash working capital items is added back.

| FREE CASH FLOWS | 2010 | 2009 |
|---|---|---|
| Cash flows from operations | $ 25,597 | $ 30,480 |
| Change in non-cash working capital items | 1,763 | (5,429) |
| Conversion costs | – | 2,655 |
| | $ 27,360 | $ 27,706 |
| Per share – Basic | $ 2.12 | $ 3.14 |
| Per share – Fully Diluted | $ 1.84 | $ 2.65 |

The Company generated Free Cash Flows of $27.4 million for 2010, which is consistent with the $27.7 million generated in the comparative 2009 year.

On a basic per share basis, Free Cash Flows for 2010 decreased to $2.12, or $1.84 on a fully diluted basis. This is a decrease in comparison to the comparative period in 2009 of 32% and 31%, respectively. The decrease in the per share results is the result of the increase in the shares outstanding for the Company as discussed above in the Distributable Cash section.

**Reconciliation of Cash Flow from Operations to Distributable Cash**

| | 2010 | 2009 |
|---|---|---|
| Cash flow from (used in) operating activities | $ 25,597 | $ 30,480 |
| Overhaul accrual | (1,168) | (312) |
| Changes in non-cash operating working capital items | 1,763 | (5,429) |
| Maintenance capital expenditures, net of gain on sale/disposal of capital assets | (2,161) | (2,132) |
| Conversion costs | – | 2,655 |
| Other | (295) | (395) |
| Distributable Cash | $ 23,736 | $ 24,867 |

The following table provides disclosure regarding the relationship between cash flows from operating activities and net earnings for the 2010 year compared to historical distributed cash amounts.

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Cash flow from operating activities | $ 25,597 | $ 30,480 | $ 19,039 |
| Net earnings for the year | 12,894 | 12,989 | 3,188 |
| Dividends/distributions declared | 20,342 | 14,060 | 8,862 |
| Excess (shortfall) of | | | |
| Cash flows from operating activities over dividends/distributions declared | 5,255 | 16,420 | 10,177 |
| Net earnings for the year over dividends/distributions declared | $ (7,448) | $ (1,071) | $ (5,674) |
| Payout ratios | | | |
| Over cash flow from operating activities | 79.5% | 46.1% | 46.5% |
| Over net earnings for the year | 157.8% | 108.2% | 278.0% |

Based on the information in the table above, a shortfall of net earnings for 2010 year over the dividends declared exists and the reason for the shortfall can be attributed to a number of factors. First, the number of shares outstanding during the 2010 year without any corresponding increase in net earnings or cash flows from operations causes a shortfall as dividends are paid on the outstanding shares. This is discussed previously above in the Distributable Cash section. The Company intends to utilize its available debt facility for future acquisitions which will remedy the de-leveraged balance sheet that the Company currently has outstanding as at December 31, 2010 and therefore the Company believes that this situation is only temporary. As described above, subsequent to 2010 the Company announced the closing of the acquisition of Bearskin and announced the intent to acquire Westower. Also contributing to the shortfall is the Manufacturing segment's suppressed earnings as a result of the economic slowdown, especially experienced by Stainless in the US marketplace. The factors that contributed to the consolidated financial results for 2010 are discussed in Section 4 – Analysis of Operations below in comparison to 2009. Also impacting net earnings negatively is the amortization of intangible assets that are purchased at the time of acquisitions. The intangible assets are depreciable assets that do not need to be replaced with cash from the Company. As a result, the amortization of intangible assets increases the magnitude of any shortfall.

No debt obligations were incurred by the Company to satisfy dividend payments. No covenants were breached and no waivers or consents were required or requested. The net cash position of the Company is $1.5 million as at December 31, 2010, which is a decrease of $3.4 million over the net cash position as at December 31, 2009.

**Dividends/Distributions and Payout Ratio**

Actual dividends for the 2010 year totaled $20.3 million, which was an increase of 45% from the comparative 2009 year when the actual payouts were $14.1 million. Per share dividends for 2010 totaled $1.56, which were equal to the combined dividends and distributions paid per share in the comparative 2009 year.

The payout ratio for the actual dividends for 2010 compared to Distributable Cash was 85%, or 96% when calculated on a fully diluted basis. The payout ratios for the combined actual dividends and distributions for the comparative 2009 period were 56% or 65% fully diluted. The payout ratios for the 2010 periods were negatively impacted by the increase in the number of shares outstanding during the year as discussed previously in the Distributable Cash section above.

The payout ratio is considered to be prudent and is reviewed by the Company's Board of Directors on a quarterly basis.

The Board of Directors for the Company regularly examines the dividends paid to shareholders. The current dividend rate per share is $0.13 per month. Management expects that the Company will generate sufficient cash going forward into 2011 to meet or exceed this level.

The amounts and record dates of the combined distributions and dividends declared during the 2010 year and comparative 2009 year were as follows:

| | 2010 Dividends | | | 2009 Distributions and Dividends | | |
|---|---|---|---|---|---|---|
| Month | Record date | Per share | Amount | Record date | Per share | Amount |
| January | January 29, 2010 | $ 0.13 | $ 1,418 | January 30, 2009 | $ 0.13 | $ 776 |
| February | February 26, 2010 | 0.13 | 1,487 | February 27, 2009 | 0.13 | 777 |
| March | March 31, 2010 | 0.13 | 1,545 | March 31, 2009 | 0.13 | 778 |
| April | April 30, 2010 | 0.13 | 1,614 | April 30, 2009 | 0.13 | 1,174 |
| May | May 31, 2010 | 0.13 | 1,691 | May 29, 2009 | 0.13 | 1,184 |
| June | June 30, 2010 | 0.13 | 1,701 | June 30, 2009 | 0.13 | 1,284 |
| July | July 30, 2010 | 0.13 | 1,714 | July 28, 2009 | 0.13 | 1,284 |
| August | August 31, 2010 | 0.13 | 1,754 | August 31, 2009 | 0.13 | 1,318 |
| September | September 30, 2010 | 0.13 | 1,802 | September 30, 2009 | 0.13 | 1,323 |
| October | October 31, 2010 | 0.13 | 1,849 | October 30, 2009 | 0.13 | 1,372 |
| November | November 30, 2010 | 0.13 | 1,879 | November 30, 2009 | 0.13 | 1,389 |
| December | December 30, 2010 | 0.13 | 1,888 | December 31, 2009 | 0.13 | 1,401 |
| Total | | $ 1.56 | $ 20,342 | | $ 1.56 | $ 14,060 |

Fourth Quarter Key Performance Indicators

| KEY PERFORMANCE INDICATORS – FOURTH QUARTER | 2010 | per share basic | per share fully diluted | 2009 | per share basic | per share fully diluted |
|---|---|---|---|---|---|---|
| EBITDA | $ 8,101 | | | $ 9,039 | | |
| Distributable Cash | 5,736 | $ 0.40 | $ 0.38 | 6,493 | $ 0.62 | $ 0.51 |
| Dividends Declared | 5,616 | $ 0.39 | | 4,162 | $ 0.39 | |
| Capital Expenditures | 12,062 | 0.84 | 0.67 | 7,829 | 0.74 | 0.54 |
| Free Cash Flows | 7,146 | 0.50 | 0.45 | 7,236 | 0.69 | 0.56 |

The Company generated EBITDA of $8.1 million for the fourth quarter of 2010, a decrease of $0.9 million or 10% from the comparative period in 2009. The change in EBITDA is discussed in Section 6 – Review of Fourth Quarter 2010 Results below.

The Company generated Distributable Cash of $5.7 million in the fourth quarter of 2010 which was a decrease of $0.8 million or 12% over the $6.5 million generated during the same period in 2009. The decrease can be mainly attributed to the net change in EBITDA and cash interest costs. The decrease in EBITDA for the period was offset by a decrease in cash interest costs of $0.3 million. The cash interest costs for the 2009 period included the Series E debentures that were redeemed earlier than the original maturity, which took place at the beginning of fiscal 2010 and therefore were not outstanding during the fourth quarter of 2010.

On a per share basis Distributable Cash was $0.40 (or $0.38 fully diluted) for the 2010 period and decreased in comparison to comparative 2009 period that was $0.62 (or $0.51 fully diluted). This was partially due to the decrease in Distributable Cash as described above. Consistent with the discussion above for the annual results, the fourth quarter 2010 Distributable Cash per share amounts were negatively impacted by the higher number of Shares outstanding as a result of new Shares issued for warrants exercised and debentures conversions that took place throughout 2010, as well the fully diluted per share amounts were further negatively impacted by the issuance of $30 million of Series H convertible debentures in April 2010 that increased the amount of the fully diluted shares. The basic shares outstanding for the 2010 period increased to 14.3 million Shares from 10.5 million Shares in the same period in 2009 (fully diluted – 2010 18.0 million Shares from 2009 14.5 million).

The Company invested $12.1 million in capital expenditures in the fourth quarter of 2010 (2009 – $7.8 million). Approximately $0.8 million was classed as maintenance capital expenditures (2009 – $0.7 million) with the balance of $11.3 million classified as growth expenditures (2009 – $7.1 million). Included in the growth expenditures for the fourth quarter of 2010 are the Company's purchases associated with the new Keewatin contract for $8.4 million of buildings, aircraft and other equipment needed for the commencement of that contract. The other Aviation segment entities also made growth expenditures totaling $2.9 million for various other aircraft, hangars and other equipment purchases.

The Free Cash Flows generated by the Company during the fourth quarter of 2010 of $7.1 million are relatively consistent with the $7.2 million generated for the same period in 2009. On a per share basis, the Company's Free Cash Flows for the fourth quarter of 2010 was $0.50, or $0.45 fully diluted. This was a decrease of 27% and 20%, respectively, in comparison to Free Cash Flows of $0.69 and $0.56 fully diluted that was generated in the same period in 2009. As described above, the per share amounts for 2010 were further negatively impacted by the higher number of Shares outstanding and the fully diluted per share amounts were negatively impacted by the Series H convertible debentures outstanding.

## 4. ANALYSIS OF OPERATIONS

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Aviation | Manufacturing | Head Office[2] | Consolidated | Aviation | Manufacturing | Head Office[2] | Consolidated |
| Revenue | $ 189,321 | $ 55,373 | $ – | $ 244,694 | $ 153,480 | $ 57,771 | $ – | $ 211,251 |
| Expenses[1] | 157,519 | 48,419 | 6,351 | 212,289 | 122,405 | 50,877 | 5,238 | 178,520 |
| EBITDA | 31,802 | 6,954 | (6,351) | 32,405 | 31,075 | 6,894 | (5,238) | 32,731 |
| Interest expense | | | | 8,057 | | | | 7,652 |
| Amortization of intangible assets | | | | 1,099 | | | | 1,417 |
| Depreciation | | | | 9,373 | | | | 7,913 |
| Conversion costs | | | | – | | | | 2,655 |
| Foreign exchange losses (gains) on debt | | | | (55) | | | | (1,052) |
| Impairment loss | | | | – | | | | 553 |
| Earnings before taxes | | | | 13,931 | | | | 13,593 |
| Current income tax expense (recovery) | | | | – | | | | (30) |
| Future income tax expense (recovery) | | | | 1,037 | | | | 634 |
| Net earnings for the year | | | | $ 12,894 | | | | $ 12,989 |

(1) Expenses exclude interest expense, depreciation, amortization, non-cash expenses and any unusual non-operating one-time items.
(2) Head-office is not a separate reportable segment. It includes expenses incurred at the head-office of the Company and is presented for reconciliation purposes.

On a consolidated basis, revenue for the Company for 2010 increased by 16% or $33.4 million to $244.7 million when compared to the comparative 2009 year. The main driver of the increase in revenue for the year is the addition of Calm Air, which was acquired in April 2009 and therefore the 2010 year includes three months of operations with no comparative in 2009. The revenues for the Aviation segment increased by 23% to $189.3 million when compared to 2009 and the revenues for the Manufacturing segment decreased by 4% to $55.4 million when compared to 2009.

On a consolidated basis, EBITDA of $32.4 million for the Company for 2010 was consistent with the $32.7 million generated during the comparative 2009 year. The EBITDA for the Aviation segment increased by 2% to $31.8 million when compared to 2009 and the EBITDA for the Manufacturing segment was relatively stable at $7.0 million when compared to 2009. Costs incurred at the head-office of the Company increased 21% to $6.4 million when compared to 2009.

**Aviation Segment**

| Aviation Segment | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Revenue | $ 189,321 | $ 153,480 | $ 35,841 | 23% |
| Expenses | 157,519 | 122,405 | 35,114 | 29% |
| EBITDA | $ 31,802 | $ 31,075 | $ 727 | 2% |

The revenues for the Aviation segment for 2010 included the operations of Calm Air for the complete year and totaled $189.3 million, which is an increase of $35.8 million from 2009 that included approximately nine months of operations for Calm Air from the acquisition date in April 2009. The Calm Air revenues increased by $25.7 million or 40% over the 2009 revenues generated. Revenues earned at Calm Air during the first three months and seven days of 2010 were $21.0 million. In addition, Calm Air revenues increased during 2010 as a result of strong demand for charter and cargo services, including the revenue generated from hauling fuel to remote Northern First Nation Communities in Northwestern Ontario that started with the new contract in 2010. The addition of fixed based fuel operations in Winnipeg, Thompson and Churchill, Manitoba and Red Lake, Ontario has contributed $5.3 million of ancillary revenues for the period in 2010 since being added. There was no comparable revenue stream in 2009 and this revenue figure includes only sales to third parties, as sales to the other entities within the Aviation segment are eliminated upon consolidation. The operational results of Perimeter continued to grow in 2010 as revenues increased by $5.8 million or 9% over 2009. The increases came from passenger levels and charters growing as capacity grew with the addition of new aircraft during the year and customer relationships continuing to improve. Perimeter also benefited in the spring of 2010 from a shorter than normal winter road season in the first quarter of 2010 which helped increase both passenger and cargo volumes.

The increases in revenue streams described above have been offset by a 4% decline in Keewatin's revenues that have come mainly as a result of a decline in medevacs in the Nunavut region. Changes in levels and acuity of illness in the remote regions of Nunavut can fluctuate and that directly impacts the medevac revenues earned and volumes of medevacs declined in 2010 over 2009 levels. Keewatin is the sole service provider in the region and will also be under the Baffin Island region for the medevac contract that started for Keewatin at the end of the 2010 year. Only fifteen days of operations under the new contract were available and $0.3 million of revenue was recognized during 2010.

Even though the revenues generated for the Aviation segment increased significantly, the EBITDA generated for 2010 was more moderate with an increase of $0.7 million or 2% over 2009. The decrease in the EBITDA margin for the Aviation segment can be attributed to several factors which offset the $2.9 million of EBITDA generated by Calm Air for the first three months and seven days of 2010 which has no comparable in 2009. Firstly, a new medevac contract was awarded to Keewatin for the Baffin Island region that commenced near the end of 2010 but required a significant amount of costs to be incurred, and capital expenditures, in order to prepare for the start of the contract. A total of $1.2 million of costs were incurred by Keewatin in association with these start-up costs that only generated revenue and EBITDA for the last couple of weeks of the year in 2010. Secondly, the certification and overhaul process that Calm Air has experienced in getting the two purchased ATR-72 aircraft operational has taken longer than expected. Certain cargo related service contracts that Calm Air entered into for 2010 that was originally planned to use the fuel efficient ATR-72 aircraft had to be done using older and less cost efficient aircraft that not only held less cargo but have higher fuel burn rates and higher maintenance costs per flight hour due to the age of those aircraft. Thirdly, the cost of fuel used by the segment's entities has continued to increase throughout 2010. The Company manages this cost closely to ensure that fuel surcharges are added to the cost of the ticket for the customers when it is considered necessary and justified. Fourthly, the increased competition for Calm Air and Keewatin on scheduled services resulted in some lost passenger revenues and suppressing margins for those routes that the competition exists. Lastly, the increased ancillary revenue coming from the fixed based fuel operations in the three Manitoba locations is a low margin business and the margin recognized on the third party sales puts a drag on the whole segment's results as it grows.

### Manufacturing Segment

| Manufacturing Segment | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Revenue | $ 55,373 | $ 57,771 | $ (2,398) | -4% |
| Expenses | 48,419 | 50,877 | (2,458) | -5% |
| EBITDA | $ 6,954 | $ 6,894 | $ 60 | 1% |

Revenues generated by the segment overall decreased by $2.4 million or 4% for 2010 compared to the prior year. The revenue for Stainless decreased by $5.5 million, which is a combined result of a decline of US $3.0 million in sales and of a stronger Canadian dollar in 2010 over the comparative year. The last quarter of 2010 has begun to show some improvements in the sales for Stainless that was anticipated as a result of Stainless' order book increasing since the middle of fiscal 2010. Given that the contracts for Stainless' products are generally larger in nature and requiring significant capital by the customer, the sales events often have longer lead times until revenues are recognized. Combined Alberta operations have decreased revenues of $0.5 million or 2% during 2010 and this was offset by an increase of $3.5 million or 48% in revenues generated by the precision metal manufacturing business in British Columbia.

Even with the decline in revenues for the Manufacturing segment, the EBITDA generated by this segment was stable with growth of less than $0.1 million. Consistent with the impact above for Stainless' revenues, the decrease in US sales and the stronger Canadian dollar both contributed to a reduction in costs for Stainless and EBITDA for Stainless decreased by $2.9 million. The other entities within the segment all improved their EBITDA generated which offset the decrease at Stainless. The improvement at these entities included cost reduction initiatives that dealt with a soft economy for the majority of fiscal 2010 and the improvement specifically at Overlanders' precision metal manufacturing business as a result of the significant growth they realized from increased volumes and some new manufacturing equipment added for the last half of fiscal 2010. The Alberta operations have also seen an improvement during the last half of fiscal 2010 as the Alberta oil and gas market began to improve. The EBITDA margins for the Water Blast operations were stable even during the soft Alberta oil and gas market without the Company losing market share. Drilling activity in the Alberta oil and gas market has been increasing during 2010, as well as production in the oil sands. More contracts are going out for tender by the large oil and gas companies and there is less equipment in auction yards, which leads to increased sales volume for new equipment to fill the demand.

### Head Office

| Head Office Costs | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Expenses | $ 6,351 | $ 5,238 | $ 1,113 | 21% |

The increase of $1.1 million or 21% in costs incurred at the head-office of the Company for 2010 over 2009 is mainly a result of higher levels of personnel costs. As the head-office grows in size with the growth in the Company overall, compensation costs increase and the compensation costs incurred also increase with the appreciation of the Company's share price that impact the value of the Company's share-based compensation programs that were outstanding during the year. These programs that are for individuals at all of the entities of EIC are fair valued using the Company's end of year share price which was 37% higher for December 31, 2010 than December 31, 2009. Other head-office costs outside of compensation for 2010 are relatively consistent with amounts incurred in comparative 2009.

### Other Non-EBITDA Items

The following analyzes the changes in the other non-EBITDA income statement items for the 2010 year in comparison to 2009 that impacted the change in consolidated net earnings. Consolidated net earnings for the 2010 year was $12.9 million, a decrease of less than $0.1 million over the comparative 2009 year.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Interest expense | $ 8,057 | $ 7,652 | $ 405 | 5% |

The Company incurred additional interest costs for 2010 of $0.4 million or 5% in comparison to the comparative 2009 year. This is a result of changes in the types of debt items outstanding in the 2010 year. Interest incurred by the Company coming from convertible debentures increased by $1.0 million for 2010. The Series G convertible debentures that were issued in the third quarter of 2009 were outstanding throughout 2010 and the Series H convertible debentures that were issued in April 2010 were not outstanding at all in the comparative 2009 year. Both of these series of convertible debentures contributed to higher interest on convertible debentures. Offsetting the additional interest items from the Series G and Series H convertible debentures were the Series E debentures that were redeemed in January 2010 and the Series A convertible debentures that matured in May 2009, both of which were outstanding for all or the portion of the comparative 2009 year. Also impacting the debentures interest were the various conversions totaling $19.4 million that were exercised throughout 2010 of outstanding convertible debentures into Shares of the Company and the maturity of the Series B and C convertible debentures in July and September of 2010, respectively.

Interest incurred on long-term debt items decreased by $0.6 million in 2010. The Company had a significantly lower average balance outstanding in its credit facility in 2010 versus 2009 and that was the main reason for the decrease overall in interest incurred on long-term debt items. The average credit facility balance drawn was 51% lower in 2010 and was the result of the Company using proceeds from the issuance of the Series G and Series H convertible debentures to pay down long-term debt levels. The lower debt levels were offset by higher interest rates and unutilized credit facility fees. The Company incurred $0.7 million in unutilized credit facility fees during the 2010 period as a result of the decision to pay down its credit facility in order to have it available for future use in funding acquisitions.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Amortization of intangible assets | $ 1,099 | $ 1,417 | $ (318) | -22% |

The amortization of intangible assets expensed by the Company is impacted by new acquisitions that generally recognize new intangible assets. There were no acquisitions made by the Company during 2010 and the comparative 2009 year was when Calm Air was acquired. As a result the amortization expense for the 2010 period is lower by less than $0.3 million.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Depreciation | $ 9,373 | $ 7,913 | $ 1,460 | 18% |

Depreciation expensed by the Company increased by $1.5 million or 18% in 2010 over the comparative 2009 year. This is mainly the result of the additional depreciation of $0.9 million from Calm Air in the first three months of the 2010 period that has no comparable in 2009 as a result of Calm Air being acquired in April 2009. The remainder is due to the overall increase in capital asset levels that took place in 2010, including the capital expenditures as part of the internal growth initiatives that the Company made which are described above in Section 2 – Overview.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Conversion costs | $ – | $ 2,655 | $ (2,655) | -100% |

As a result of the Company converting to a corporation during 2009, the Company incurred professional fees in association with the conversion. These fees were incurred in 2009 and are considered as a one-time item as the conversion process was completed in 2009.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Foreign exchange losses (gains) on debt | $ (55) | $ (1,052) | $ 997 | -95% |

During 2010 the Company recorded less than $0.1 million of net foreign exchange gains as a result of the conversion of the US dollar based aircraft finance debt that was outstanding during the year. The Company repaid the remaining balance of this debt in the fourth quarter of 2010. At the end of the first quarter of 2010 the Company entered into a forward contract that matched the majority of the US dollar principal of the aircraft financing debt and caused the natural hedge of the foreign currency exposure. As a result, the Company incurred only an insignificant net foreign exchange gain on debt for 2010 while in the comparative period in 2009 the hedging forward contract was not outstanding.

The foreign exchange gains are considered to be outside of normal operations and are being recorded as a result of the aircraft financing that was outstanding. The Company kept this aircraft financing outside of its credit facility due to the near maturity of the financing and the cancellation costs of prepayment at the time of acquiring Calm Air. The aircraft financing matured in the fourth quarter of 2010 and no balance was outstanding as at December 31, 2010.

The US dollar portion of the Company's credit facility that is outstanding is accounted for differently as a result of it being considered part of the foreign currency translation of the US based operations of Stainless. Changes in the foreign currency translation of the net investment in Stainless is recorded through Other Comprehensive Income and is only recorded in net earnings when the investment is disposed of.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Impairment loss | $ – | $ 553 | $ (553) | -100% |

In 2009 the Company decided to construct a new terminal building for one of the entities within the Aviation segment because the existing building was not sufficient any longer and modifications to the existing building would not be adequate. As a result, the building was demolished and the carrying value of the building of $0.6 million ($0.4 million after-tax) was recorded by the Company as an impairment loss in 2009.

| | 2010 | 2009 | Variance | Variance % |
|---|---|---|---|---|
| Current income tax expense (recovery) | $ – | $ (30) | $ 30 | -100% |
| Future income tax expense (recovery) | 1,037 | 634 | 403 | 64% |
| Net Income Tax Expense (Recovery) | $ 1,037 | $ 604 | $ 433 | 72% |

Income tax expense for 2010 was $1.0 million, representing an increase of $0.4 million over the comparative 2009 year. 2010 was the first full year in which the Company was subject to income tax as a corporation, having completed the conversion from an income trust on July 28, 2009. Income tax expense is impacted by the amortization of the deferred income tax credit, which was recognized upon conversion to a corporation. The deferred income tax credit is amortized as income tax losses are used, resulting in a decrease in the income tax expense. The income tax expense will fluctuate depending on how other temporary differences are changing. During the 2010 period, the Company recorded $3.2 million amortization of the deferred tax credit (2009 – $1.0 million).

## 5. SUMMARY OF QUARTERLY RESULTS

| | | | | 2010 | | | | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 |
| Revenue | $ 67,631 | $ 63,588 | $ 60,219 | $ 53,256 | $ 58,028 | $ 60,175 | $ 55,852 | $ 37,196 | $ 40,793 |
| EBITDA | 8,101 | 8,786 | 8,556 | 6,962 | 9,039 | 11,128 | 8,478 | 4,086 | 5,597 |
| Net earnings/(loss) | 3,272 | 3,606 | 3,654 | 2,362 | 3,703 | 3,869 | 4,032 | 1,385 | (2,968) |
| Basic | 0.23 | 0.27 | 0.29 | 0.21 | 0.35 | 0.39 | 0.46 | 0.24 | (0.51) |
| Diluted | 0.22 | 0.26 | 0.27 | 0.20 | 0.33 | 0.36 | 0.44 | 0.24 | (0.51) |
| Free cash flow | 7,146 | 7,538 | 7,036 | 5,640 | 7,236 | 9,966 | 7,039 | 3,465 | 5,733 |
| Distributable cash | 5,736 | 6,655 | 6,120 | 5,225 | 6,493 | 8,986 | 6,673 | 2,715 | 4,005 |
| Basic | 0.40 | 0.50 | 0.49 | 0.47 | 0.62 | 0.90 | 0.76 | 0.46 | 0.68 |
| Diluted | $ 0.38 | $ 0.42 | $ 0.39 | $ 0.39 | $ 0.51 | $ 0.77 | $ 0.69 | $ 0.43 | $ 0.61 |

As a result of the one-to-one conversion of units of the Fund into shares of the Company in July 2009, there is no impact of the conversion on the earnings per share calculations as the units of the Fund are directly comparable to the shares of the Company. As a result, the per share results above compare consistently with the historically presented per unit results for the periods before the conversion.

## 6. REVIEW OF FOURTH QUARTER 2010 RESULTS

| | Three months ended December 31, 2010 | | | | Three months ended December 31, 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Aviation | Manufacturing | Head Office[2] | Consolidated | Aviation | Manufacturing | Head Office[2] | Consolidated |
| Revenue | $ 51,586 | $ 16,045 | $ – | $ 67,631 | $ 45,122 | $ 12,906 | $ – | $ 58,028 |
| Expenses[1] | 43,768 | 13,852 | 1,910 | 59,530 | 35,788 | 11,556 | 1,645 | 48,989 |
| EBITDA | $ 7,818 | $ 2,193 | $ (1,910) | $ 8,101 | $ 9,334 | $ 1,350 | $ (1,645) | $ 9,039 |

(1) Expenses exclude interest expense, depreciation, amortization, non-cash expenses and any unusual non-operating one-time items.
(2) Head-office is not a separate reportable segment. It includes expenses incurred at the head-office of the Company and is presented for reconciliation purposes.

Historically the fourth quarter for the Aviation segment is weaker than the second and third quarters but the fourth quarter revenues for the Aviation segment were $51.6 million and higher than the segment's revenues for the third quarter of 2010. In comparison to the comparable period in 2009, revenues for the fourth quarter of 2010 increased by $6.5 million or 14%. The majority of the increase is a result of the ancillary revenues to third parties generated by the fixed based fuel operations in the three Manitoba and one Ontario locations that generated sales of $3.5 million in the 2010 period with no comparative in 2009. All the other existing entities within the segment increased revenues in the 2010 period mainly as a result of increased cargo and charter revenues in the far north by Calm Air, and increased charter and passenger volumes for Perimeter. Consistent with the annual discussion above, the increase at Calm Air for the fourth quarter of 2010 includes the additional revenue from the cargo hauling of fuel to remote locations.

The EBITDA generated by the Aviation segment for the fourth quarter of 2010 wasn't consistent with the increase in revenues as a result of a few items. Firstly, the start-up costs incurred by Keewatin in preparation for the commencement of its new medevac contract in the Baffin Island region of Nunavut that included a variety of costs that were needed to ensure that Keewatin was properly staffed and trained prior to the start of the contract. This was evident from the first medevac coming from the contract within an hour of the start of the contract in mid-December. The total start-up costs incurred was $1.2 million and the revenue and EBITDA from the contract will be seen going forward in the 2011 results. Secondly, the EBITDA margins for the ancillary revenue generated by the fixed based fuel operations is much lower than the rest of the operations of the segment and results in a drag on the segment's overall EBITDA generated in comparison to the prior year with no comparative for this ancillary revenue. Thirdly, the increased competition for Calm Air and Keewatin on scheduled services resulted in some lost passenger revenues and suppressing margins for those routes that the competition exists. Lastly, the increase in fuel prices with the rise in commodity prices in the fourth quarter in comparison to the same period in 2009 has resulted in a decrease in EBITDA that the segment's entities haven't recovered from fuel surcharges put on services provided. Historically the Company has been reluctant to amend any fuel surcharges given the relationships built with its customers, in particular the First Nations Communities who use the services of the segment as a necessity. This is monitored regularly by the management teams within the segment's entities they make fuel surcharge adjustments when considered necessary and justified.

All the entities within the Manufacturing segment showed an increase in revenues recognized in the fourth quarter of 2010 and as a result revenue for the segment increased by $3.1 million or 24% over the comparable period in 2009. The largest increase came from Stainless that increased by $2.1 million and is a result of the increase in US sales by $2.4 million and offset by the stronger Canadian dollar during the 2010 period. Consistent with the annual discussion, the sales in Stainless are coming as a result of the increasing order book that began around the middle of fiscal 2010.

The increase in revenues resulted in an increase in the Manufacturing segment's EBITDA by $0.8 million. This increase came mainly from the improved results in the operations of Jasper that increased by $0.5 million and Water Blast that increased $0.4 million as a result of the improving Alberta oil and gas market. Stainless' increased revenue recognized in the quarter was offset by a couple larger projects that were finalized and resulted in lower margins, on its overall EBITDA for the quarter.

The costs incurred at the head-office of the Company during the fourth quarter of 2010 was $0.3 million or 16% higher than the same period in 2009. Consistent with the discussion for the annual discussion above for head-office costs, the increase is related to additional personnel-related costs as at the head-office staffs up for the oversight of a much larger corporate entity.

## 7. LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2010, the Company had a net cash position of $1.5 million and net working capital of $48.8 million, which represents a current ratio of 2.00 to 1.

| | December 31, 2010 | December 31, 2009 | Change |
|---|---|---|---|
| Cash and cash equivalents | $ 1,471 | $ 4,857 | $ (3,386) |
| Cash – restricted | 27,625 | – | 27,625 |
| Accounts receivable | 30,276 | 20,922 | 9,354 |
| Inventory | 28,269 | 27,234 | 1,035 |
| Prepaid expenses | 3,809 | 2,401 | 1,408 |
| Future income tax | 6,154 | 4,560 | 1,594 |
| Accounts payable and accrued expenses | (35,210) | (26,031) | (9,179) |
| Deferred revenue | (7,819) | (6,626) | (1,193) |
| Current portion of long-term debt | – | (2,943) | 2,943 |
| Current portion of convertible debentures | (1,052) | (5,761) | 4,709 |
| Current portion of debentures | – | (9,691) | 9,691 |
| Current portion of deferred credit | (4,700) | (3,464) | (1,236) |
| Net working capital (deficiency) | $ 48,823 | 5,458 | $ 43,365 |

There are several factors that contributed to the significant improvement from the $5.5 million of net working capital at year-end 2009. Most significantly, the position at year-end 2010 was impacted positively by the $27.6 million of restricted cash that relates to the funds held in trust by legal counsel for the acquisition of Bearskin that was closed on January 1, 2011. In addition, at year-end 2009 the Company's net working capital was negatively impacted by the circumstances surrounding the timing of the repayment of the Series E debentures that were redeemed in January 2010. The announced early redemption of the outstanding Series E debentures in 2009 resulted in the presentation of the $9.7 million liability as current, which negatively impacted the year-end 2009 net working capital. Also negatively impacting year-end 2009 was the presentation of the Series B and Series C convertible debentures that matured in 2010. Offsetting the Series B and Series C combined outstanding balance is the smaller Series D convertible debenture balance that will mature in 2011. Lastly, the aircraft financing debt that the Company assumed as part of the acquisition of Calm Air in 2009 was presented as a current liability of $2.9 million at year-end 2009 but was paid off in its entirety throughout 2010.

Throughout 2010 the Company received funds from the exercising of warrants. A total of 2,096,631 warrants were exercised during 2010 that provided $21.0 million in cash for the Company. The funds received were used to pay for capital expenditures and payment against the Canadian dollar portion of the Company's credit facility. The Company's dividend reinvestment plan during 2010 resulted in the issuance of 115,995 Shares of the Company for total proceeds of $1.7 million.

During the second quarter of 2010 the Company closed the issuance of the Series H convertible senior secured debentures with a seven year maturity (May 2017), a fixed 6.5% per annum interest rate and a $20.00 conversion price. This offering was a bought deal and the Company initially used the net proceeds to reduce the Company's credit facility outstanding and certain other debt items. Net proceeds of $28.4 million were obtained from this issuance.

On January 11, 2011, the Company announced the closing of its five-year fixed 5.75% Series I convertible senior secured debentures. The Company issued $35.0 million principal amount of these debentures and the Company used $32.0 million of the net proceeds received for the repayment of debt outstanding in the Company's credit facility. The conversion price on these debentures is $26.00.

As at December 31, 2010, the Company had a $106.0 million syndicated secured debt facility that was split into a $95.7 million Canadian dollar facility and US $10.3 million facility. As at December 31, 2010, $46.0 million of the Canadian dollar facility and US $7.5 million of its US debt facility ($7.4 million) was outstanding. This amount is shown on the balance sheet in Canadian dollars, net of unamortized transaction costs. As part of the acquisition of Bearskin on January 1, 2011, the Company drew $27.6 million prior to year-end from the Company's credit facility and these funds were held in trust and shown on the balance sheet of the Company at year-end 2010 as restricted cash within current assets. During 2010 the three-year revolving credit facility was extended another year and now expires in May 2013. As at December 31, 2010, the Company was in compliance with all financial covenants associated with its credit facility. As part of the acquisition of Calm Air in April 2009, the Company assumed debt with Credit Lyonnais for aircraft within Calm Air's fleet. The final payment on this aircraft financing debt was paid in the fourth quarter of 2010 and therefore no balance was outstanding as at year-end 2010.

The Company has multiple series of convertible debentures outstanding as outlined below. During 2010 the Company had two series of convertible debentures mature (Series B and Series C) and returned principal to the debenture holders for a combined total of $0.5 million. A combined total of $5.4 million of principal in the Series B and C convertible debentures was converted into Shares of the Company in 2010 prior to each of the maturity dates in the third quarter. As of December 31, 2010, there was $1.1 million of principal in Series D convertible debentures, which will mature within the 2011 year. The conversion price for the Series D convertible debentures is $13.25 per share. At the time of this report, the Company's current share price is above the conversion price, which could result in more of the Series D debentures converting into Shares of the Company before the maturity date. Regardless of the principal balance outstanding on the Series D convertible debentures at maturity, the Company anticipates having adequate resources to fund these debentures outstanding, utilizing a combination of current cash on hand, cash flow generated from operations and, if necessary, the credit facility. If considered advantageous at the time, in accordance with the terms of these series of debentures, the Company has the ability to settle these debentures through the issuance of Shares.

The Company obtained additional cash through the means described above and also generated $25.6 million from its operations during 2010 (or $27.4 million of Free Cash Flows). The Company used these funds for significant capital expenditures and the repayment of certain debt items, enabling the Company to fund future acquisitions through its credit facility. The Company does not normally raise funds in advance of having a target acquisition; however, the interest rate of the Series H convertible debenture was not materially higher than the cost of locking in a seven-year fixed rate on its long-term debt. As mentioned above, the Company closed the acquisition of Bearskin at the beginning of 2011. The cash portion of the purchase price was withdrawn from the Company's credit facility. Based on the debt outstanding at year-end 2010 in the Company's credit facility, the Company has approximately $55 million available for future growth. As mentioned above, the Company used $32.0 million of the net proceeds from the Series I convertible debenture issuance that closed in January 2011 to pay down the balance outstanding and leaving the Company approximately $85 million available for future growth. This capacity will be further increased when the Company's credit facility is increased and extended another year as part of the planned closing of the Westower acquisition.

During 2010, but especially during the second half of fiscal 2010, the Company has made significant investments in its internal growth. As described above in Section 3 – Key Performance Indicators, the majority of the capital expenditures were made in the Aviation segment in order to service two newly awarded contracts for Calm Air and Keewatin. A total of $44.9 million of capital expenditures were made during 2010 by the Aviation segment, with $26.0 million of that being made during the last six months of 2010. The Manufacturing segment also made capital expenditures of $1.4 million during 2010 for a variety of items, including the new equipment purchased at Overlanders to increase its production capacity.

The Company's dividends are dependent on its ability to generate cash flow from operations. The monthly dividend paid in absolute dollars continues to grow with the continued trend for the debentureholders and warrant holders converting their instruments into Shares of the Company. The Company has continued to declare dividends of $0.13 per share per month throughout fiscal 2010 and has been able to do this through generating $25.6 million of cash flow from operations in comparison to the $20.3 million of dividends declared during 2010. On a free cash flow basis before changes in non-cash working capital items, the Company generated $27.4 million during 2010.

The following summarizes the changes in the Shares outstanding of the Company during the 2010 year:

| | Date issued | Number of shares |
|---|---|---|
| Shares outstanding, beginning of year | | 10,780,704 |
| Issued from warrants exercised | various | 2,096,631 |
| Issued under dividend reinvestment plan (DRIP) | various | 115,995 |
| Issued upon conversion of convertible debentures | various | 1,499,096 |
| Issued to TCIG[(1)] | April 19, 2010 | 26,416 |
| Shares outstanding, end of year | | 14,518,842 |

(1) Amounts earned by the Tribal Council Investment Group ("TCIG"), a related party of the Company, were paid in Shares of the Company in accordance with the marketing agreement between the parties.

With the acquisition of Bearskin at the beginning of 2011 and the continued conversion of outstanding convertible debentures, the Shares outstanding have changed subsequent to December 31, 2010. The following summarizes the changes in the Shares outstanding of the Company subsequent to year-end 2010 up to February 28, 2011:

| | Date issued | Number of shares |
|---|---|---|
| Shares outstanding, January 1, 2011 | | 14,518,842 |
| Issued from warrants exercised | various | 243,801 |
| Issued under dividend reinvestment plan (DRIP) | various | 25,909 |
| Issued upon conversion of convertible debentures | various | 662,040 |
| Issued for Bearskin vendor | January 1, 2011 | 314,047 |
| Shares outstanding, February 28, 2011 | | 15,764,639 |

The following summarizes the changes in the warrants outstanding of the Company during the 2010 year:

| 2010 | Date issued | Number of warrants |
|---|---|---|
| Warrants outstanding, beginning of year | | 2,505,313 |
| Warrants exercised | various | (2,096,631) |
| Warrants outstanding, end of year | | 408,682 |

As described above, subsequent to year-end 2010 the Company has had 243,801 warrants exercised during the 2011 period up to February 28, 2011. The warrants outstanding will expire in the second quarter of 2011.

The following summarizes the convertible debentures outstanding as at December 31, 2010 and the changes in the amount of convertible debentures outstanding during the 2010 year:

| | | Par Value Debentures Outstanding |
|---|---|---|
| Series B, 8% SENIOR SECURED, JULY 8, 2010 MATURITY CONVERTIBLE AT $11.50 | | |
| Outstanding beginning of year | $ 3,385 | |
| Debentures converted into shares | (3,136) | |
| Debentures repaid upon maturity | (249) | |
| Total Series B debentures outstanding, end of year | | $ – |
| Series C, 8% SENIOR SECURED, SEPTEMBER 1, 2010 MATURITY CONVERTIBLE AT $13.25 | | |
| Outstanding beginning of year | 2,500 | |
| Debentures converted into shares | (2,260) | |
| Debentures repaid upon maturity | (240) | |
| Total Series C debentures outstanding, end of year | | – |
| Series D, 8% SENIOR SECURED, AUGUST 12, 2011 MATURITY CONVERTIBLE AT $13.25 | | |
| Outstanding beginning of year | 7,000 | |
| Debentures converted into shares | (5,925) | |
| Total Series D debentures outstanding, end of year | | 1,075 |
| Series F, 10% SENIOR SECURED, APRIL 8, 2014 MATURITY CONVERTIBLE AT $10.75 | | |
| Outstanding beginning of year | 4,095 | |
| Debentures converted into shares | (2,121) | |
| Total Series F debentures outstanding, end of year | | 1,974 |
| Series G, 7.5% SENIOR SECURED, SEPTEMBER 30, 2014 MATURITY CONVERTIBLE AT $14.50 | | |
| Outstanding beginning of year | 30,000 | |
| Debentures converted into shares | (5,966) | |
| Total Series G debentures outstanding, end of year | | 24,034 |
| Series H, 6.5% SENIOR SECURED, MAY 31, 2017 MATURITY CONVERTIBLE AT $20.00 | | |
| Debentures issued | 30,000 | |
| Total Series H debentures outstanding, end of year | | 30,000 |
| Total convertible debentures outstanding, end of year | | $ 57,083 |

As described above, subsequent to year-end 2010 the Company has had principal of $9.5 million of convertible debentures converted into 662,040 Shares of the Company during the 2011 period up to February 28, 2011.

The following are the contractual obligations of the Company and its subsidiaries as at December 31, 2010:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1–3 years | 4–5 years | After 5 years |
| Long-term debt | $ 53,410 | $ – | $ 53,410 | $ – | $ – |
| Debentures – series D, F–H | 57,083 | 1,075 | – | 26,008 | 30,000 |
| Operating leases | 14,990 | 3,792 | 3,237 | 1,694 | 6,267 |
| Total contractual obligations | $ 125,483 | $ 4,867 | $ 56,647 | $ 27,702 | $ 36,267 |

Subsequent to December 31, 2010, the Company closed the bought deal offering of $35.0 million principal amount in five-year 5.75% Series I convertible senior secured debentures with a $26.00 conversion price on January 11, 2011.

## 8. RELATED PARTY TRANSACTIONS

The Company has a marketing agreement with Tribal Councils Investment Group ("TCIG"), whose president is a director of the board of the Company. The agreement is in the normal course of operations, at market terms and conditions, except that the compensation is payable to TCIG in either Shares of the Company or cash, and is recognized in the consolidated financial statements at the exchange amounts. The compensation to TCIG is conditional on the annual increase in sales at Perimeter. The Company incurred commissions of $0.1 million in 2010 (2009 – $0.4 million). The amount payable to TCIG at December 31, 2010 is $0.2 million (2009 – $0.4 million).

Certain Water Blast retail and manufacturing locations in Alberta are leased from the current president of Water Blast who was the vendor that sold Water Blast to the Company. These leases are considered to be at market terms and recognized in the consolidated financial statements at the exchange amounts. These leases are scheduled to end in the beginning of 2012. The total costs incurred in 2010 under these leases are $0.7 million (2009 – $0.7 million) and recorded under general and administrative expenses, and, at December 31, 2010, there is no related party balance recorded on the balance sheet (2009 – nil).

With the acquisition of Stainless effective January 2, 2008, certain buildings are leased by Stainless from the vendors, one of whom is the current president of Stainless. The lease is considered to be at market terms and is recognized in these consolidated financial statements at the exchange amount. The lease term expires in 2013. The total costs incurred during 2010 are approximately $0.4 million and recorded under general and administrative expenses (2009 – $0.4 million). As at December 31, 2010, there is no related party balance recorded on the balance sheet (2009 – nil). The future minimum lease payments under the lease are approximately US $0.4 million annually.

The Company's legal counsel is Aikins, MacAulay & Thorvaldson LLP ("Aikins") in Winnipeg, Manitoba, whose Managing Partner is a director on the board of the Company. The transactions are at market terms and conditions. These transactions are in the normal course of operations associated with legal professional services and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Depending on the services provided, certain costs are expensed in the period incurred, some costs that are considered transaction costs associated with financial liabilities are recognized as interest expense over the life of the related financial instrument, while other costs associated with the raising of equity are recorded as issuance costs against the related equity item. The total costs of services provided during 2010 are $1.2 million (2009 – $2.3 million). As at December 31, 2010, a payable balance of less than $0.6 million is recorded on the balance sheet (2009 – less than $0.1 million).

The Company has had business relationships with Wellington West Capital Inc. ("Wellington West") in Winnipeg, Manitoba. The chairman of the board of directors for the Company is also a member of the board of Wellington West. The transactions are at market terms and conditions. These transactions are in the normal course of operations associated with the raising of funds for the Company through private and public offerings, and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Depending on the services provided, certain costs are expensed in the period incurred, some costs that are considered transaction costs associated with financial liabilities are recognized as interest expense over the life of the related financial instrument, while other costs associated with the raising of equity are recorded as issuance costs against the related equity item. The total costs of services provided during 2010 are $0.1 million (2009 – $0.8 million). The amount payable to Wellington West recorded as at December 31, 2010 is nil (2009 – nil).

## 9. ACCOUNTING POLICIES AND ESTIMATES

### Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates are deemed critical when a different estimate could have reasonably been used or changes in accounting estimates are reasonably likely to occur from period to period and these different estimates would have a material impact on the Company's consolidated financial statements.

The significant areas requiring the use of management estimates are disclosed in Note 2 of the Notes to the Consolidated Financial Statements for 2010. The Company's management believes that the following accounting estimates are critical as described above.

### Business Combination

The Company's acquisitions have been accounted for using the purchase method of accounting. Under the purchase method, the acquiring company adds to its balance sheet the estimated fair values of the acquired company's assets and liabilities. There are various assumptions made when determining the fair values of the acquired company's assets and liabilities. The most significant assumptions and those requiring the most judgment involve the estimated fair values of intangible assets. The intangible assets acquired that require critical accounting estimates are customer contracts, customer relationships, customer lists, certifications and brand name. To determine the fair value of these intangible assets, the Company adopted the excess earning method. This valuation technique values the intangible assets based on the capitalization of the earnings, which are calculated to be in excess of what a reasonable amount of earnings would be on the tangible assets used to generate the earnings associated with the intangible asset. Significant assumptions include, among others, the determination of projected revenues, cash flows, customer retention rates, discount rates and anticipated average income tax rates.

### Goodwill and Intangible Asset Impairment

Goodwill and certain intangible assets are not amortized. Goodwill and all intangibles are assessed for impairment at least annually. Any potential impairment is identified by comparing the fair value of the business to its carrying value. An impairment loss would be recognized to the extent that the carrying value of goodwill or intangibles exceeds the implied fair value. Fair value of goodwill or intangibles is estimated in the same manner that the Company uses to determine fair value upon acquisition of a business. Significant assumptions include, among others, the determination of normalized earnings and earnings multiples.

### Overhaul Provision

The purpose of the reserve is to ensure that the cost to overhaul a capital component of an aircraft and to perform the hot section inspection is expensed evenly over the period that the item is used and generates income. An amount is accrued for every hour flown. The accrual rate is set so that when the expenditure is incurred, the liability approximates the amount of the required expenditure to bring the item back to the condition when acquired. To calculate the accrual rate, management estimates the cost to perform a standard overhaul and divides this by the flying hours before the overhaul is performed. The accrual rate is reviewed annually to ensure that the costs have not changed significantly. Any variations between the amounts accrued and the actual cost for the overhaul is expensed in the period occurred.

### Stainless Revenue Recognition

Stainless operates under long-term contracts of production and revenue is recognized on a percentage-of-completion basis. The percentage of completion for each contract is based on contract costs incurred to date compared with total estimated contract costs. The percentage complete is then applied to total anticipated revenues for that contract to determine the period's revenue recognized. The percentage complete, estimated contract costs and estimated contract revenues are reviewed monthly by management. Any changes from management's review of these estimates are recorded in that period.

### Aviation Segment Revenue Recognition

The Company performs regular evaluations on the deferred revenue liability for passenger tickets purchased in advance within the Aviation segment's operating entities. These evaluations may result in adjustments being recognized as revenue. Due to the complexity of the pricing and systems, historical experience, and other factors including refunds, exchanges and unused tickets, certain amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates.

### Future Income Taxes

The determination of the Future Income Tax Asset requires an analysis as to how the asset is expected to reverse in the future. Management has prepared estimates of the reversal of temporary differences based on income projections. Results as determined by actual events could differ from these estimates.

### Changes in Accounting Policies

The critical accounting policies are substantially unchanged from those identified in the MD&A of the Company for the year ended December 31, 2009.

### Future Accounting Standards

The following is an overview of accounting standard changes that the Company will be required to adopt in future years:

### IFRS Update

The Company will be required to convert to International Financial Reporting Standards ("IFRS") as a publicly accountable enterprise for the fiscal year beginning on January 1, 2011. The Company mobilized an IFRS project team to develop an IFRS transition plan, assess and coordinate ongoing training requirements, and complete an initial IFRS/ Canadian GAAP diagnostic. The overall IFRS transition plan is divided into three separate phases and will take the Company through its conversion to IFRS. The Company has also entered into an engagement with a professional services firm to assist with the whole transition process. Experiences noted from the transition to IFRS in other jurisdictions have shown that net earnings may tend to become more volatile, and the volume and complexity of the financial disclosures will increase.

The Company's first phase of its overall IFRS transition plan included an IFRS/ Canadian GAAP diagnostic which provided an overview of the significant differences between IFRS and Canadian GAAP. The Company's second phase of its overall IFRS transition plan included complete component evaluations on significant accounts and processes and resolve significant issues. The evaluations will be used by the Company to prepare a set of mock IFRS-compliant financial statements. The third phase of the project is the integration of any business, internal control and IT changes required.

During the 2010 year, the Company's IFRS project team has completed the second phase of Company's overall IFRS transition plan. As a result it has completed component evaluations on significant accounts and processes. The finalization of the set of mock IFRS-compliant financial statements is being finalized for reporting under IFRS for the first quarter of 2011. The Company is also finalizing the required integration of any business, internal control and information technology changes. The changes described below are not audited and are based on management's current estimates. Such amounts may change due to the finalization of estimates and such changes may be significant. Accordingly reasonable ranges of adjustments have been provided pending the finalization of the adjustments. The Company's preliminary assessment of areas that will have a significant impact upon adoption of IFRS consist of, but may not be limited to:

- Overhaul accrual method of accounting – Under Canadian GAAP the Aviation segment accrues an overhaul liability as aircraft assets are used in operations and a corresponding charge to direct operating expenses. Then when the overhaul event takes place the liability is relieved. In accordance with IFRS, the Company will be required to amend its accounting policy, such that costs of overhaul-related services will not be accrued but rather the cost of the overhaul event will be added to the cost of the related capital asset and amortized over the period to the next planned major overhaul. The opening balance sheet adjustment will include the removal of the overhaul accrual balance through opening retained earnings and the set-up of the net book value for the most recent overhaul events. The Company's Canadian GAAP overhaul accrual balance reported for year-end 2009 was $7.6 million.
- Capital assets – The Company under IFRS is required to identify the significant component parts of its items of capital assets and depreciate those parts over their respective useful lives. Canadian GAAP only requires componentization to the extent practicable. The Company has identified a certain number of aircraft related assets with significant component parts within the Aviation segment that will be depreciated separately as significant components. Furthermore, certain rotable parts that were previously presented as inventory will be reclassified as capital assets due to their nature and useful lives. The opening balance sheet adjustment will include the reclassification of these certain parts from inventory to capital assets and an adjustment to the net book value of the capital assets to reflect the adjusted depreciation rates, which will go through opening retained earnings. The Company expects that capital assets will decrease between approximately $7.5 million and $8.0 million, including the impact from the change in accounting policy for the overhaul accrual. The Company expects that inventory will decrease on the opening balance sheet between $4.0 million and $4.5 million with an equivalent increase in capital assets.
- Deferred tax credit – As a result of the conversion to a corporation in 2009 the Company recognized a deferred tax credit related to acquired tax benefits in accordance with EIC 101 of Canadian GAAP. Generally a deferred credit isn't recognized under IFRS as it is inconsistent with the conceptual framework. Under IFRS this event would result in a gain being recognized in the period of the event as compared to the Canadian GAAP requirement to amortize the credit to income tax expense in

proportion to the net reduction in the future income tax asset that gave rise to the deferred credit. The opening balance sheet adjustment will include the removal of the deferred credit balances through opening retained earnings to reflect as if the gain was recognized in 2009 when the event took place. The Company's combined current and long-term portion of the deferred credit balance reported for year-end 2009 was $39.7 million.

- Loyalty program – Canadian GAAP does not provide specific guidance on accounting for customer loyalty programs. Perimeter offers a customer loyalty program where, under Canadian GAAP, it would record a liability for the cost of the program and given the characteristics of the program, the cost was not considered significant when the Perimeter customer redeems the loyalty points. In accordance with IFRS, the fair value attributed to the awarded customer loyalty program is deferred as a liability and will be recognized as revenue on redemption of the award by the participant to whom the awards are issued. The opening balance sheet adjustment will include the creation of the deferred revenue amount representing the fair value of the points outstanding on January 1, 2010 and a charge to opening retained earnings. The Company expects that deferred revenue will increase on the opening balance sheet between $1.0 million and $1.5 million.
- Borrowing costs – IFRS requires the capitalization of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Under Canadian GAAP, the Company elected the accounting policy choice to expense these costs as incurred. As described below, IFRS 1 provides an election that permits application of this requirement for borrowing costs to be done prospectively from the date of transition, January 1, 2010; therefore there is no change to the opening IFRS balance sheet.
- Asset impairment –Under certain circumstances (excluding goodwill impairments), asset impairments recorded are eligible to be reversed under IFRS. In addition, the approach for impairment testing of non-financial assets will be different under IFRS. Currently, Canadian GAAP required the two-step approach in assessing long-lived assets for impairment. In the first step a recoverability test is based on undiscounted cash flows and if the recoverability test is failed, then the asset is written down to its fair value. Under IFRS the long-lived assets carrying value is compared to discounted cash flows which could result in the recognition of impairment losses earlier than under Canadian GAAP. Additionally, under Canadian GAAP assets are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities for impairment testing purposes. IFRS requires that assets be tested for impairment at the level of cash generating units, which is the lowest level of assets that generate largely independent cash inflows. This lower level grouping could result in identification of impairment more frequently under IFRS, but of potentially smaller amounts. The impairment testing for the opening balance sheet and at December 31, 2010 continues to be finalized.
- Income taxes – The Company has not identified any differences in the recognition and measurement of deferred income taxes under IFRS outside of the impact from the changes coming from the deferred tax credit described above; however, the Company will determine the deferred tax impact of each of the other accounting changes described above. Per the requirements of IFRS 1, the deferred tax adjustment will be recorded in opening retained earnings upon transition to IFRS.

PRELIMINARY UNAUDITED IMPACT ON SIGNIFICANT LINE ITEMS ON THE 2010 STATEMENT OF EARNINGS

The following illustrates the Company's preliminary unaudited estimated pre-tax impact to specific items on 2010 statement of earnings. This table does not present all of the 2010 IFRS adjustments, rather, only the most significantly affected items are included. The remaining adjustments are not expected to have a material net impact on the Company's 2010 IFRS earnings before tax.

| (millions) | Canadian GAAP | Preliminary (unaudited) IFRS Adjustments | Preliminary (unaudited) IFRS |
|---|---|---|---|
| Revenue | $ 245 | $ – | $ 245 |
| Expenses | 213 | (12) | 201 |
| EBITDA | 32 | 12 | 44 |
| Interest expense | 8 | – | 8 |
| Amortization of intangible assets | 1 | – | 1 |
| Depreciation | 9 | 9 | 18 |
| Foreign exchange losses (gains) on debt | – | – | – |
| Earnings before taxes | $ 14 | $ 3 | $ 17 |

FIRST-TIME ADOPTION OF IFRS

The transition to IFRS requires the Company to apply IFRS 1, or the requirement for preparing IFRS-compliant financial statements in the first reporting period after the changeover date. IFRS 1 applies only at the time of changeover, and includes a requirement for retrospective application of each IFRS, as if they were always in effect. IFRS 1 also mandates certain exceptions to retrospective application and provides a series of optional exemptions from retrospective application to ease the transition to the full set of IFRS.

The following are the more significant optional exemptions available under IFRS 1 which the Company is currently considering. This is not an exhaustive list and does not encompass all exemptions.

| IFRS 1 Exemptions | Expected Application Of Exemptions |
| --- | --- |
| Business combinations | *Entities can elect to not retrospectively restate any of the business combinations that occurred prior to the transition date.*<br><br>The Company will use the IFRS 1 election to not restate any business combinations occurring prior to January 1, 2010. Goodwill arising from business combinations occurring before transition will not be adjusted from the carrying value predetermined under Canadian GAAP except as required under IFRS 1. |
| Fair value as deemed cost for property, plant and equipment | *IFRS 1 permits first time adopters to measure an item of property, plant and equipment upon transition to IFRS at fair value, as opposed to recreating depreciated cost under IFRS.*<br><br>The Company has chosen to retrospectively measure its property, plant and equipment and intangible assets at historic cost. Had the Company taken the optional exemption, it could record the fair value of property, plant and equipment and intangible assets at the transition date for individual assets. |
| Borrowing costs | *This exemption allows an entity to adopt IAS 23 – Borrowing Costs prospectively to projects for which the capitalization commencement date is after January 1, 2010 or it may elect any date earlier than January 1, 2010 for transition.*<br><br>The Company will use the IFRS 1 election to not restate borrowing costs on qualifying assets incurred prior to January 1, 2010. |
| Share-based payments | *The exemption allows the first-time adopter to not apply IFRS 2 – Share-based Payment to equity instruments granted after November 7, 2002 that vested before transition to IFRS and it also allows the first-time adopter to not apply IFRS 2 to liabilities settled before the transition date.*<br><br>The Company will use the IFRS 1 election to not restate share-based compensation for share options vesting before January 1, 2010. |
| Cumulative translation differences | *IFRS 1 allows entities to elect that cumulative translation differences for all foreign operations be deemed zero at the date of transition to IFRS, instead of recalculating from inception. This would result in the reclassification of amounts in accumulated other comprehensive income to retained earnings on transition.*<br><br>The Company will use the IFRS 1 election and accordingly will reclassify the cumulative translation differences at January 1, 2010 to retained earnings. |
| Leases | *This exemption allows entities to determine whether an arrangement contains a lease based on the facts and circumstances at the transition date rather than at the lease inception date in accordance with IFRIC 4 – Determining Whether An Arrangement Contains A Lease. Furthermore, if a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRS.*<br><br>As the Company previously applied EIC 150 – Determining Whether An Arrangement Contains A Lease, no significant impacts are expected. |
| Designation of previously recognized financial instruments | *IFRS 1 provides an entity a choice to elect to designate a financial asset as available for sale or to designate a financial asset or liability at fair value through net earnings, provided certain criteria are met at the transition date.*<br><br>The Company does not intend to change the classification of any financial instruments existing at the transition date. |

IFRS 1 allows for certain other optional exemptions, however, the Company does not expect such exemptions to be significant to the Company's adoption of IFRS.

The information above regarding the transition to IFRS should not be regarded as a complete list of changes that will result from transition to IFRS, as new exposure drafts will be reviewed by the Company in 2011 prior to the reporting of the first quarter results for 2011 of the Company that will be under IFRS. The discussion is intended to highlight those areas the Company believes to be most significant.

KEY IT AND DATA SYSTEMS REQUIREMENTS

No significant changes have been required or planned to the Company's information technology infrastructure based on the changes made in determining the preliminary adjustments to the opening balance sheet under IFRS.

INTERNAL CONTROL OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS AND PROCEDURES

The Company is in the process of finalizing its impact of divergences on our internal controls in determining the transition adjustments to IFRS. The areas identified to date that have changed do not appear to materially affect, or is reasonably likely to materiality affect, our internal controls over financial reporting and disclosure controls and procedures. The majority of the changes have been around the reporting of the Aviation segment's capital assets recognition and depreciation, and the recognition and measurement of Perimeter's loyalty program.

FINANCIAL REPORTING EXPERTISE, INCLUDING TRAINING REQUIREMENTS

Certain members of senior management have attended external training seminars on relevant IFRS standards and their potential impact. The Company worked with its Board of Directors, Audit Committee and other employees, as appropriate in educating them of the identified differences for the Company. The senior management team, the Audit Committee and the Board of Directors are provided formal updates as required on the progress and decision making surrounding the transition to IFRS.

BUSINESS ACTIVITIES

Based on the divergences identified to date, the Company has not noted any significant changes in contractual arrangements, including debt covenants, executive compensation arrangements or other arrangements, that would be significantly negatively impacted by the adoption of IFRS.

## 10. CONTROLS AND PROCEDURES

**Internal Controls over Financial Reporting**

Management is responsible for establishing and maintaining internal controls over financial reporting in order to provide reasonable assurance with regards to the reliability of financial reporting and preparation of financial statements in accordance with Canadian GAAP.

An assessment of internal controls over financial reporting was conducted by the Company's management, under supervision by the Chief Executive Officer and Chief Financial Officer. Management has used the Internal Control – Integrated Framework to evaluate the Company's internal controls over financial reporting, which is recognized as a suitable framework developed by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

Management has evaluated the design of the Company's internal controls over financial reporting as of December 31, 2010, and based on that evaluation has concluded that such internal controls over financial reporting are not effective, due to the following material weaknesses:

Control weaknesses exist around information technology general controls, including controls around change management, security, and access controls. This weakness in information technology general controls has the potential to result in material misstatements in the financial statements as well as in appropriate authorizations of transactions. Although the information technology control design has been completed for some of the subsidiaries during 2010, further design of information technology controls on the remaining subsidiaries has yet to be completed. The Company continues to work on the design, evaluation and implementation of information technology controls.

The assessment of control design was completed for Calm Air which was purchased during 2009. Control weakness was identified with regards to the recording of revenue, specifically the completeness of revenue and the timing of revenue recognition. This design weakness has the potential to result in material misstatements of revenue, accounts receivable, deferred revenue, net income and retained earnings. Management is implementing enhanced accounting and control procedures with respect to the recording and recognition of revenue. Management has also engaged in carrying out certain additional procedures until these enhanced accounting policies and control procedures have been implemented and are determined to be sufficient.

There have been no other material changes to the Company's internal controls during the 2010 year that have materially affected or are likely to materially affect the internal controls over financial reporting.

### Disclosure Controls and Procedures

Management has established and maintained disclosure controls and procedures in order to provide reasonable assurance that material information relating to the Company is made known to management in a timely manner and that information required to be disclosed by the Company is reported within the time periods prescribed by applicable securities legislation. Due to the substantial overlap between internal controls over financial reporting and disclosure controls and procedures, management has concluded that disclosure controls and procedures as at December 31, 210 were not effective.

## 11. RISK FACTORS

### Risk Management

The Company and its subsidiaries are subject to a number of business risks. These risks relate to the structure of the Company and to the operations at the subsidiary entities. The following sections summarize the principal risks and uncertainties that could affect the Company's future business results going forward and explains how these risks are managed to an acceptable level.

### Economic Conditions

The Canadian and U.S. economies continued to go through difficult times during fiscal 2010 that existed already in 2009. Both economies declared being in a recession at some point during this time and experienced a significant reduction in commodity prices, weakened global economic growth and tight global credit conditions. Some indicators of recovery, especially in the Canadian economy, started to appear near the end of 2009 and the beginning of 2010, but both economies continue to show continued weakness. The weaker economies that the Company operates in impact the ability of the Company to sustain its operating results or create any growth.

The Manufacturing segment, with the exception of Overlanders, has continued to witness softer demand for products and services throughout 2010. The U.S. market in particular that Stainless operates continued to show signs of customers putting on hold or cancelling capital projects as businesses try to reduce funding for major projects until the economy shows signs of improvement. The Alberta market that focuses on the oil and gas industry was softer in 2010 compared to the pre-2009 period but with commodity prices starting in the second half of fiscal 2010 there has been some improvement in that economy. All the entities within the Manufacturing segment continue to pursue a number of initiatives that try to mitigate this risk through finding additional customers, increasing focus on service work, maximizing efficiency and controlling costs. This segment historically has some time lag between the economy's recovery and financial improvements as the customers can be hesitant with their projects as they are larger and requiring more capital have to first realize the benefits of the recovery and then commit the funds, which is usually not immediate given the size of certain projects. The risk of a continued soft economy for the Manufacturing segment exists which could result in decreased revenues and profitability.

The characteristics of the markets that the Aviation segment operates within are not impacted by the state of the overall economy as directly as the Manufacturing segment. This is a result of a large portion of the services being considered a necessity, such as medevacs and government travel, versus a consumer choice. The reductions in certain commodity prices, such as aviation fuel, witnessed during 2009, have actually benefited the Aviation segment through reduced costs to operate. As the Canadian economy began to show some signs of recovery and certain commodity prices began to increase in 2010, the Aviation segment could experience reduced margins if pricing of services cannot recover those increased costs from customers.

### Interest Rates

As at December 31, 2010, the Company's syndicated credit facility has a variable interest rate on the Canadian and US portions of the amount outstanding under the facility. A one-percentage point increase in average interest rates would cost the Company approximately $0.5 million per annum for the credit facility. Subsequent to 2010 the Company used the net proceeds from the issuance of Series I convertible debentures to reduce the amount outstanding under the credit facility by $32 million. After taking this payment against the balance outstanding in the Company's credit facility into consideration, a one-percentage point increase in the average interest rates would cost the Company approximately $0.2 million per annum. The terms of the credit facility allow for the Company to choose the base interest rate between Prime, Bankers Acceptances or London Inter Bank Offer Rate (LIBOR). The Company manages the base rate used on the outstanding facility to mitigate this risk and seeks financing terms in individual arrangements that are most advantageous. No derivative instruments are used by the Company to mitigate this risk beyond this level. The Company's outstanding debentures have fixed interest rates which are not affected by changes in rates.

### Fuel Prices

Fuel is a very significant cost component in the operation of the Aviation segment. Each $0.01 increase per litre in the average cost of fuel increases the operating costs of the segment by approximately $0.5 million. While most of the travel by the Aviation segment's customers is not discretionary (i.e. for medical or other necessary reasons) and overland travel from and to many of the communities serviced is only possible for brief periods of the year over winter roads, if prices were to escalate significantly it may impact demand for services. Second, if the competitive environment was to change, and the companies were unable to pass these increased costs on to the customer, future profits would be negatively impacted.

The operations of the Manufacturing segment entities in Alberta act somewhat as a hedge to changes in the fuel prices. As oil prices are low, the Aviation segment benefits from lower input costs but lower oil prices have a negative impact on Alberta operations in the Manufacturing segment as the lower oil prices hurt the Alberta oil and gas market. As oil prices increase, fuel costs increase for the Aviation segment but this will increase demand for products manufactured by the Alberta operations in the Manufacturing segment.

### Competition

The Company believes that it is an industry leader in its Aviation segment and strives to be as well in its Manufacturing segment. The Company recognizes that there are threats in the operating environment, which may challenge each segment's ability to sustain their market leadership positions.

The Aviation segment currently focuses on niche markets in Manitoba, Ontario and Nunavut. The Aviation segment would be exposed to downside earnings risk if a well capitalized competitor were to startup operations in the niche markets where the entities currently operate. At the beginning of 2010, new competition entered into the Kivalliq region where Calm Air and Keewatin operate scheduled services. Management's approach on this new competition, which is consistent with all competitors, has been to continue to deliver exceptional services at a competitive price that has historically been successful given the operational cost structure and fleet of these Aviation segment entities. The acquisition of Bearskin in January 2011 expands the geographic market area that the Aviation segment operates in Ontario. As a result the Aviation segment's exposure to downside earnings risk grows with the addition of Bearskin and the new market area with additional competitors.

The Aviation segment has historically dealt well with changes in the competitive landscape through its low cost of operation, fleet of appropriately sized owned aircraft and its relationship with its customers. Each of the entities within the Aviation segment, including Bearskin in 2011, have significant competitive advantages and barriers to entry in their respective markets. As the Aviation segment has grown, including the size of the overall fleet of aircraft, the ability for the entities to support each other has given it an ability to take advantage of opportunities that would not normally be available if these individual entities were restricted to only their own aircraft. The impact of competition in the Aviation segment could result in reduced revenue and profitability, in particular, during the short term.

The Manufacturing segment focuses on specific geographical regions and therefore some risks exist that a downturn will impact some regions, like Alberta which has seen a downturn in the oil and gas industry. As well, the US economy downturn specifically impacts the operations of Stainless. Water Blast and Jasper are both working to provide high levels of service and maintain customer relationships which will benefit them in the longer term. As commodity prices increase, the opportunity for increased revenues and profitability rises. Stainless has continued to expand its product offering and large scale field projects that it was previously not able to produce in order to mitigate the economy downturn.

### Government of Nunavut Contracts

Keewatin has medical evacuation contracts with the Government of Nunavut, which provide Keewatin with the exclusive rights to provide medical evacuations ("medevacs") in the Kivalliq and Baffin Island regions of Nunavut. Both contracts provide Keewatin with a fixed base fee to cover the costs of operating in Nunavut plus a variable fee per hour flown. During 2008, the Kivalliq contract was extended to 2010 and with some extensions that have been given it will expire in June 2011, therefore there is a risk that Keewatin will not retain or extend the contract, which would have a significant negative effect on the business of Keewatin at that time. The Baffin Island region contract is a five year contract and commenced in December 2010 but there is a risk that Keewatin will not retain or extend the contract at the end of the contract, which would have a significant negative effect on the business of Keewatin at that time.

This risk factor is mitigated by their long standing relationship with the Government of Nunavut and Keewatin's proficiency in long distance medical evacuation for the most acute level of care. Keewatin has been performing medevac services in the Kivalliq region since 1971 and has integrated their services into the Government of Nunavut's medical program by providing medical training, medical supplies and medical evacuation statistics to the communities it services. As well, Keewatin was awarded the medevac contract for the Baffin Island region during 2010 that commenced at the end of the fourth quarter of 2010.

Keewatin and Calm Air also have contracts with the Government of Nunavut for a certain share of medical travel market, where they provide medical-related travel on scheduled services to communities in the Kivaliq region of the Nunavut territory. The current contract expires in July 2011 and there is a risk that one or both of these entities will not retain their share of the medical travel market or extend the contract, which could have a significant negative effect on their business at that time.

### Food Mail Program

The Federal government of Canada provides subsidies to reduce the costs of transporting nutritious food into northern and remote communities. Historically this was accomplished through a program whereby northern retailers and individuals could ship certain healthy foods by mail from southern centers to the north. The food mail price of shipment was lower than the normal price of air shipments to these communities and Canada Post absorbed the loss. Canada Post entered into contracts with airlines to ship the food mail on a timely basis. Both Calm Air and Perimeter have contracts with Canada Post to provide this service.

Effective April 1, 2011, the food mail program will come to an end. It is being replaced with something called the nutrition north program. This new program is similar in its goals but does not utilize Canada Post to provide the shipping subsidy. Rather retailers will be provided subsidies directly from the government for the shipment of certain healthy foods. The retailer will negotiate their own shipping arrangements with the air carriers. While Calm Air and Perimeter have longstanding relationships with these retailers (e.g. Northern Stores), there is a risk that they will not be successful in negotiating arrangements with these retailers. Loss of this freight volume would have a negative impact on the businesses of Calm Air and Perimeter.

### Key Personnel

The success of the Company is dependent on a number of key senior employees both at the Company's head-office level and at the Company's subsidiary level. The loss of any one of these key employees would impair the Company's ability to operate at its optimum level of performance. Management recognizes this dependency and has been developing a strong second level of managers that would be able to fill the void if a key employee departs.

### Income Tax Matters

The business and operations of the Company and its subsidiaries are complex and the Company has undertaken a number of significant financings, reorganizations, acquisitions and other material transactions including the Arrangement over the course of its history. The computation of income taxes payable as a result of these transactions involves many complex factors including the Company's interpretation of relevant tax legislation and regulations. While management believes that the provision for income tax is adequate and in accordance with Canadian GAAP and applicable legislation and regulations, tax filing positions are subject to review by taxation authorities who may challenge the Company's interpretation of the applicable tax legislation and regulations. In that regard, the Company receives from time to time correspondence from taxing authorities concerning its tax filing positions including, most recently, a request for information for a time period which includes the Arrangement. If any challenge to the Company's tax filing positions were to succeed, it could result in a reassessment of taxes or otherwise have a material adverse effect on the Company's tax position.

Furthermore, Canadian and federal or provincial tax legislation may be amended, or its interpretation changed (whether by legislative or judicial action or decision), retroactively or for the future, so as to alter fundamentally the availability of the tax pools of the Company, which could materially adversely affect the Company's tax position.

### Capital Markets

One of the objectives of the Company is continuing to acquire additional companies or interests therein in order to expand and diversify the Company's investments. The ability to execute this objective is dependent on the Company's ability to raise funds in the capital market. If the capital market's desire for income producing investments, such as the shares of the Company, were to significantly decrease, the Company would have difficulty in executing its acquisition objective. For example, the economic downturn in the credit markets in North America that occurred in 2009 put constraints on the Company and added costs associated with obtaining financing at that time.

### Labour Relations

Certain employees within the Aviation segment have labour-related agreements but there can be no assurance that future agreements with employees' unions or the outcome of arbitrations will be on terms consistent with the Company's expectations or comparable to agreements entered into by the Company's competitors. Any future agreements or outcome of negotiations, mediations or arbitrations including in relation to wages or other labour costs or work rules may result in increased labour costs or other charges which could have a material adverse effect on the Company's business, results from operations and financial condition.

There can be no assurance that there will not be a labour conflict that could lead to an interruption or stoppage in the Company's service or otherwise adversely affect the ability of the Company to conduct its operations, all of which could have a material adverse effect on its business, results from operations and financial condition. Several union groups and associations have labour agreements that become due in 2011. The contract for the maintenance association at Calm Air expires in the second quarter of 2011. At Bearskin, the contract with its maintenance staff also expires in the second quarter of 2011, and the contracts with the ground handlers, groomers, certain counter and reservation staff, and flight crew staff all expire in the fourth quarter of 2011.

### Hotsy Distributorship Contract

The Water Blast business has an exclusive distributorship agreement for the Hotsy line of products that is sells for all of Alberta and British Columbia. The loss of this distributorship agreement would have a significant negative impact on Water Blast's business. This risk factor is mitigated by Water Blast's long-term relationship with Hotsy, as well as the length of the distributorship agreement. The distributorship agreement is a 10-year agreement, extended annually, for exclusivity as it relates to third parties from Hotsy, subject to reasonable performance criteria.

### Foreign Exchange

The Company's financial results are sensitive to the changing value of the Canadian dollar. In particular, the Company's subsidiaries have significant annual net outflow of US dollars and is affected by fluctuations in the Canada/US dollar exchange rate. Outflows for expenses include items such as aircraft lease costs and related parts purchased for the Aviation segment, and Hotsy machines and parts purchased by the Manufacturing segment. A significant deterioration of the Canadian dollar relative to the US dollar would result in increased costs and adversely affect the profitability of the Company.

A portion of the Company's revenues are generated in US dollars through its operations, primarily Stainless, which acts as a natural hedge and mitigates the foreign exchange risk of the Company. No derivative instruments are used by the Company to mitigate this risk beyond this level. The expected addition of Westower as a result of the announced intent to acquire by the Company subsequent to 2010 will also increase the US dollars generated from the US portion of Westower's operations.

### Accident

The operating subsidiaries of the Company are subject to the inherent business risk of liability claims and adverse publicity if any of their services is alleged to have resulted in adverse effects to a user, including an aircraft accident in the case of the entities within the Aviation segment. The operating subsidiaries currently carry liability insurance that management believes is adequate under their current circumstances, although there can be no assurance that such circumstances will not change and that such insurance will remain available at reasonable costs, if at all. In the event of an inadequately insured liability claim, the business and financial condition of the operating subsidiaries could be materially adversely affected.

### Acquisition Strategy

The Company's ability to successfully grow through additional acquisitions will be dependent on a number of factors, including: the identification of suitable acquisition targets in both new and existing markets; the negotiation of purchase agreements on satisfactory terms and prices; securing attractive financing arrangements; and, where applicable, the integration of newly acquired operations into the existing business. Any acquisition will involve a number of risks, including: the potential acquisition of previously undisclosed liabilities; as well as the potential disruption of the Company's ongoing business and the diversion of management's attention from its day-to-day operations. An unsuccessful acquisition could have a material adverse impact on the Company, its results of operations and financial condition. For greater certainty, shareholders are totally dependent upon the Company's management and Board of Directors in making investment decisions.

## 12. OUTLOOK

### ACQUISITION STRATEGY

On January 1, 2011 the Company closed the acquisition of Bearskin Airlines at a purchase price of $32.5 million and will be part of the consolidated group of companies within the Aviation segment starting in fiscal 2011. The Company has announced that it has entered into a letter of intent to acquire Westower for $79.0 million. The expectation is that this transaction will close at the beginning of the second quarter of 2011, subject to completion of due diligence. The Company continues to examine a number of other acquisition opportunities given the under levered balance sheet and available senior credit facility that the Company has available to make acquisitions.

The Company has developed a network of referral sources that regularly present it with potential acquisitions. The Company believes that its disciplined approach to acquisitions is largely responsible for the success that has been experienced to date. While the deal flow brought to the Company is considered to be strong, there can be no assurance that target companies that meet the Company's standards will be uncovered.

While the capital markets can be highly volatile and there can be no assurances that the Company will be able to access these markets if an acquisition opportunity arises, the Company's historical success of raising capital during both good markets and poor markets, its track record of profitability and the creditability of previous accretive acquisitions gives it confidence of being able to continue the strategy going forward.

After the Company closed the Bearskin acquisition on January 1, 2011 and with the expected acquisition of Westower, the Company's leverage will still be well under its stated target of senior debt that is two times EBITDA. The Company will still have approximately $140 million available under its amended credit facility upon closing the planned Westower acquisition.

### AVIATION SEGMENT

The Aviation segment has two significant contracts with the Government of Nunavut expiring in 2011. The first is Keewatin's medevac (air ambulance) contract for the Keewatin district and the second is the medical transport contract for passengers travelling on both Keewatin and Calm Air's scheduled service. Keewatin's medevac contract was issued over eight years ago and after several extensions, expires at the end of June 2011. The Company believes that there was at least one other bid, but remains confident that Keewatin will retain the contract as it is the only company with any infrastructure in the area to support the operations in this extreme northern area. The Government of Nunavut is said to be very happy with the service offered by Keewatin in this niche industry. The medical transport contract was a three year contract and expires in April 2011 and the Government of Nunavut has asked for a four month extension in order to review bids for this tender. The tender is expected to have multiple bidders including an existing competitor providing jet service between Rankin and Winnipeg. Keewatin currently has 33% of this contract and Calm Air, via a subcontract with Canadian North, has the other 67%. It would be unrealistic for the Company to expect to retain 100% of this business overall. Offsetting a potential loss of any portion of the medical travel business could potentially be the government duty travel (employee travel) which has not been tendered previously but is a part of the upcoming tender. The Company's current competitor maintains most of this business on their jet. Calm Air and Keewatin will both review the makeup of their fleet to ensure it is optimal for the tender process.

As discussed above in Section 11 – Risk Factors, the food mail program wherein the shipment of healthy foods to northern and remote communities will be replaced on April 1, 2011 with a new program called the nutrition north program. Historically the Federal government, through Canada Post, contracted with air carriers to ship healthy foods to the north and then set a discounted postal rate to allow retailers and end users to ship these nutritious foods at a discounted rate. This program has been replaced with a direct subsidy to retailers who will then make their own shipping arrangements. Both Calm Air and Perimeter have contracts with Canada Post to provide this service under the food mail program. These contracts will need to be replaced with contracts with the retailers. Both airlines have longstanding relationships with these customers and expect to retain this freight business.

Calm Air purchased two ATR 72 aircraft, one at the end of 2009 and the other during the third quarter of 2010. Both of these aircraft experienced significant delays in obtaining Transport Canada certification, which has caused these aircraft to sit idle for several months. Late in the third quarter of 2010 Calm Air received Transport Canada's approval to operate the first ATR 72 and it went into service at that time. The second ATR 72 that was purchased in the third quarter of 2010 was initially expected to go into service near the end of the fourth quarter but its introduction into Calm Air's fleet has also been delayed until the end of the second quarter of 2011 by the decision to convert the aircraft to a freighter configuration. Having both of the ATR 72's in service, will not only increase capacity but will improve margins as the ATR 72's replace older and much less efficient Hawker 748's. Until the point in time when these two ATR 72's are in service, Calm Air's margin will continue to be depressed as additional crew and maintenance costs are required for the two separate aircraft types having to be used.

With the acquisition of Bearskin now completed and Calm Air's recent award of half the Hydro One contract in Northwestern Ontario, the Company has now established a foothold in the region. The topography and market is very similar to that in Manitoba, and the Company will continue to explore opportunities to expand the core business of the Aviation segment in this market. Further expansion into this region will require additional capital expenditures for aircraft and infrastructure, or acquisition.

Northwestern Ontario and the Company's existing markets in which the Aviation segment's companies operate rely on aviation transport as an essential service, not only for passenger travel, but also to bring food and supplies into the communities. Unlike conventional aviation companies, the demand for air service in most of the communities that are serviced is not predicated on the strength of the overall economy. With the exception of the mining sector which has some impact on demand, particularly on Calm Air, the demand for service remains stable. Bearskin does operate in a segment where the strength of the overall economy does have an effect on demand. One of the mitigating factors is that Bearskin that was acquired at the beginning of 2011 services 17 communities spread over two provinces, which provides some geographic diversification. This vast geographic territory means long drives between business centers, not unlike some of Calm Air's routes, which limit vehicle travel as a competitor for those travelers wanting to do business and return home the same day.

There has been significant discussion in Manitoba regarding an all-weather road connecting many of the communities along the east side of the Province, including many of those serviced by Perimeter. While an all-weather road would reduce the frequency of service provided by Perimeter and the corresponding passenger and freight business, air service would continue to be needed for those communities similar to several communities already serviced by Perimeter and Calm Air which have road access. While an all-weather road remains a priority for the First Nations Communities of Manitoba, the financial cost to build this infrastructure in a challenging northern Manitoba topography would be extremely burdensome, and if approved would be expected to take at least a decade to complete.

With fuel prices steadily rising since 2009, both Perimeter and Calm Air implemented small price increases during the first quarter of 2011. The Company expects fuel prices to continue to rise throughout the upcoming year. Should fuel prices increase materially, further price increases may be necessary. Both of these companies are able to pass along price increases, but are mindful of any price increase as their service is essential to the communities they operate in. The Aviation segment is in a competitively strong position for fuel purchases. It has entered into an agreement to combine the fuel purchases of its three subsidiaries with a common supplier.

Management believes the outlook for the Aviation segment continues to be positive.

### MANUFACTURING SEGMENT

While the Company's Manufacturing segment entities are optimistic about a continuing strengthening of the economy, only modest signs of recovery are evident. The operations in the Alberta oil patch maintain a much stronger sense of optimism as increased activity in oil and gas drilling and production throughout the oil sands and several natural gas areas act as a catalyst for support services and manufacturing.

Stainless has seen many of the signs of economic recovery including robust quoting activity and the release of several smaller projects, but remains cautious as very few large projects that they have quoted on have been released beyond the quoting stage. Activity from across their entire customer base is evident, but to this point the activity has been limited to smaller essential projects versus larger growth oriented projects. Previous marketing efforts are evident as some new customers have been added, and some of these customers are using Stainless to quote on larger projects too. Despite the fact the order book is the strongest it has been in 18 – 24 months, it is still below the level of management's long-term expectations. If some of the larger projects in the quoting pipeline were to materialize with a signed contract, Stainless would be in a much better position to repeat pre-recession performance.

While natural gas prices still remain modest, oil prices continue to rise, which has improved the optimism of the Alberta economy. Large capital expenditure budgets for the oil sands producers and renewed drilling exploration for both oil and natural gas in several areas have driven the demand for services and manufacturing of support entities. Both Water Blast and Jasper have seen their order books increase from levels of the last 12 -24 months, and customers are increasing their expectations for orders. Orders for larger custom product has been a main driver of the larger order books for both companies of late and both have begun to conservatively ramp up staffing levels in anticipation of further recovery within that market. Increasing optimism is evident in this region.

The 2010 year was a record year for Overlanders as several new customers and sales to multiple existing customers exceeded expectations. When a new customer is added, or an existing customer adds a new product line, sales often ramp up as the customer builds a level of inventory. Once inventory levels are established, production levels stabilize to maintenance or replacement levels. This is the case for several of Overlanders' customers who themselves had record years in 2010 but are expected to level-off production in 2011. Overlanders is expected to still have a good year, we do not expect their 2010 performance to be repeated in 2011. While Overlanders has invested in additional capital expenditures to produce at peak levels during 2010, it has yet to see any significant reduction in capacity in their regional market. This has been surprising as several competitors were seen as less financially capable, and some production capacity was expected to fall away. The short term risk is that these struggling competitors will drive down prices in the short and mid-term in an effort to retain some market share.

Overall management is optimistic that the Alberta operations will continue to improve as the price of oil remains strong, and while the general economy remains slow, Stainless and Overlanders are well positioned in their respective markets to take advantage of an improvement in the overall economy, should it take place over the next several quarters.

# Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Exchange Income Corporation for the years ended December 31, 2010 and 2009, and all information in this annual report are the responsibility of management. Financial information contained elsewhere in the annual report is consistent with that shown in the consolidated financial statements. The consolidated financial statements were prepared by management in accordance with Canadian generally accepted accounting principles, applied on a consistent basis. The significant accounting policies, which management believes are appropriate for the Company, are described in Note 2 to the consolidated financial statements.

Management is responsible for the integrity and objectivity of the consolidated financial statements. Estimates are necessary in the preparation of these statements and, based on careful judgments, have been properly reflected. Management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, and to produce reliable accounting records for the preparation of financial information.

The Company's independent auditors, Deloitte & Touche LLP have been appointed by the shareholders to audit the financial statements and express an opinion thereon.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The board of directors carries out this responsibility principally through its audit committee, composed entirely of outside and unrelated directors. The audit committee meets regularly with the financial management of the Company and the independent auditors to discuss internal controls, audit matters, financial reporting issues and reports to the Board of Directors thereon. The audit committee also reviews and approves the consolidated financial statements for inclusion in the annual report. The independent auditors have full and free access to the audit committee.

**Adam S. Terwin**
Signed
Chief Financial Officer
March 11, 2011

**Michael C. Pyle**
Signed
President & Chief Executive Officer

# Independent Auditor's Report

**To the Shareholders of Exchange Income Corporation**

We have audited the accompanying consolidated financial statements of Exchange Income Corporation, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations comprehensive income, equity, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Exchange Income Corporation as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
Winnipeg, Manitoba
March 11, 2011

# Consolidated Balance Sheets

| (in thousands of dollars)<br>As at December 31 | 2010 | 2009 |
|---|---|---|
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | $ 1,471 | $ 4,857 |
| Cash – restricted (Note 27) | 27,625 | – |
| Accounts receivable | 30,276 | 20,922 |
| Inventory (Note 5) | 28,269 | 27,234 |
| Prepaid expenses | 3,809 | 2,401 |
| Future income tax (Note 16) | 6,154 | 4,560 |
| | 97,604 | 59,974 |
| CAPITAL ASSETS (Note 6) | 158,439 | 119,400 |
| INTANGIBLE ASSETS (Note 7) | 12,842 | 13,371 |
| FUTURE INCOME TAX ASSETS (Note 16) | 28,444 | 34,618 |
| GOODWILL (Note 8) | 39,678 | 40,446 |
| | $ 337,007 | $ 267,809 |
| LIABILITIES | | |
| CURRENT | | |
| Accounts payable and accrued expenses | $ 35,210 | $ 26,031 |
| Deferred revenue | 7,819 | 6,626 |
| Current portion of long-term debt (Note 9) | – | 2,943 |
| Current portion of convertible debentures (Note 10) | 1,052 | 5,761 |
| Current portion of debentures (Note 11) | – | 9,691 |
| Current portion of deferred credit (Note 16) | 4,700 | 3,464 |
| | 48,781 | 54,516 |
| LONG-TERM DEBT (Note 9) | 53,100 | 25,447 |
| CONVERTIBLE DEBENTURES (Note 10) | 49,461 | 36,150 |
| OVERHAUL ACCRUAL | 11,103 | 7,565 |
| FUTURE INCOME TAX (Note 16) | – | 638 |
| DEFERRED CREDIT (Note 16) | 31,714 | 36,191 |
| | 194,159 | 160,507 |
| EQUITY | 142,848 | 107,302 |
| | $ 337,007 | $ 267,809 |

The accompanying notes are an integral part of the consolidated financial statements. Commitments – Note 22 & Contingencies – Note 24

Approved on behalf of the directors by:

Duncan Jessiman, Director

Donald Streuber, Director

# Consolidated Statements of Operations

| (in thousands of dollars, except for per share amounts)<br>For the year ended December 31 | 2010 | 2009 |
|---|---|---|
| REVENUE | $ 244,694 | $ 211,251 |
| EXPENSES | | |
| Direct operating | 159,653 | 132,560 |
| General and administrative | 52,636 | 45,960 |
| | 212,289 | 178,520 |
| EARNINGS BEFORE THE FOLLOWING | 32,405 | 32,731 |
| Interest | 8,057 | 7,652 |
| Amortization of intangible assets | 1,099 | 1,417 |
| Depreciation | 9,373 | 7,913 |
| Conversion costs (Note 3) | – | 2,655 |
| Foreign exchange gains on debt (Note 23) | (55) | (1,052) |
| Impairment loss (Note 18) | – | 553 |
| EARNINGS BEFORE INCOME TAXES | 13,931 | 13,593 |
| INCOME TAX EXPENSE (RECOVERY) (Note 16) | | |
| Current | – | (30) |
| Future | 1,037 | 634 |
| | 1,037 | 604 |
| NET EARNINGS FOR THE YEAR | $ 12,894 | $ 12,989 |
| EARNINGS PER SHARE (Note 17) | | |
| Basic | $ 1.00 | $ 1.47 |
| Diluted | $ 0.97 | $ 1.39 |

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated Statements of Comprehensive Income

| (in thousands of dollars)<br>For the year ended December 31 | 2010 | 2009 |
|---|---|---|
| NET EARNINGS FOR THE YEAR | $ 12,894 | $ 12,989 |
| OTHER COMPREHENSIVE INCOME (LOSS), net of tax (Note 26) | (688) | (2,787) |
| COMPREHENSIVE INCOME FOR THE YEAR | $ 12,206 | $ 10,202 |

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated Statements of Equity

| (in thousands of dollars)<br>For the year ended December 31 | 2010 | 2009 |
|---|---|---|
| SHARE CAPITAL (Note 12) | $ 148,046 | $ 104,451 |
| CONVERTIBLE DEBENTURES EQUITY COMPONENT (Note 10) | | |
| Balance, beginning of year | 3,641 | 1,108 |
| Issued debentures Series F | – | 301 |
| Issued debentures Series G | – | 2,345 |
| Issued debentures Series H | 2,377 | – |
| Maturing debentures to contributed surplus | (41) | (61) |
| Issued for debenture conversions | (1,493) | (52) |
| Balance, end of year | 4,484 | 3,641 |
| WARRANTS (Note 13) | | |
| Balance, beginning of year | 952 | – |
| Issued for cash | – | 1,229 |
| Exercised | (797) | (277) |
| Balance, end of year | 155 | 952 |
| CONTRIBUTED SURPLUS | | |
| Balance, beginning of year | 61 | 96 |
| Equity component of maturing convertible debentures (Note 10) | 41 | 61 |
| Fair value benefit from ESPP recognized as compensation expense | – | (96) |
| Balance, end of year | 102 | 61 |
| (DEFICIT) RETAINED EARNINGS | | |
| CUMULATIVE EARNINGS AND DIVIDENDS/DISTRIBUTIONS | | |
| CUMULATIVE EARNINGS – Balance, beginning of year | 33,124 | 20,135 |
| Net earnings for the year | 12,894 | 12,989 |
| Balance, end of year | 46,018 | 33,124 |
| CUMULATIVE DIVIDENDS/DISTRIBUTIONS – Balance, beginning of year | (35,601) | (21,541) |
| Distributions declared (Note 15) | – | (7,257) |
| Dividends declared (Note 15) | (20,342) | (6,803) |
| Balance, end of year | (55,943) | (35,601) |
| TOTAL (DEFICIT) RETAINED EARNINGS | (9,925) | (2,477) |
| ACCUMULATED OTHER COMPREHENSIVE INCOME | | |
| Balance, beginning of year | 674 | 3,461 |
| Other comprehensive income (loss), net of tax (Note 26) | (688) | (2,787) |
| Balance, end of year | (14) | 674 |
| | (9,939) | (1,803) |
| EQUITY, end of year | $ 142,848 | $ 107,302 |

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated Statements of Cash Flows

| (in thousands of dollars)<br>For the year ended December 31 | 2010 | 2009 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net earnings for the year | $ 12,894 | $ 12,989 |
| Items not affecting cash: | | |
| Amortization of intangible assets | 1,099 | 1,417 |
| Depreciation | 9,373 | 7,913 |
| Impairment loss (Note 18) | – | 553 |
| Accretion of interest | 1,548 | 1,888 |
| Long-term debt discount (paid) accretion | 124 | (59) |
| Overhaul accrual | 1,168 | 312 |
| Foreign exchange (gain)/loss on debt (unrealized) | 72 | (541) |
| Loss/(gain) on sale of disposal of capital assets | 132 | (35) |
| Future income tax | 1,037 | 634 |
| Other | (87) | (20) |
| | 27,360 | 25,051 |
| Changes in non-cash operating working capital items (Note 21) | (1,763) | 5,429 |
| | 25,597 | 30,480 |
| FINANCING ACTIVITIES | | |
| Proceeds from (repayment of) long-term debt, net of issuance costs | 24,655 | (20,535) |
| Proceeds from issuance of debentures, net of issuance costs | 28,430 | 31,945 |
| Payment of matured debentures | (10,205) | (812) |
| Proceeds from issuance of shares, net of issuance costs | 23,046 | 36,053 |
| Proceeds from issuance of warrants, net of issuance costs | – | 1,229 |
| Cash dividends/distributions (Note 15) | (20,342) | (14,060) |
| | 45,584 | 33,820 |
| INVESTING ACTIVITIES | | |
| Purchase of capital assets, net of disposals | (46,293) | (11,552) |
| Purchase of intangible assets | (649) | (27) |
| Cash outflow for acquisitions and acquisition costs | – | (55,255) |
| Restricted cash (Note 27) | (27,625) | – |
| Cash acquired in acquisitions | – | 3,417 |
| Payment of contingent liability (Note 24) | – | (60) |
| | (74,567) | (63,477) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | (3,386) | 823 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 4,857 | 4,034 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 1,471 | $ 4,857 |
| Supplementary cash flow information | | |
| Interest paid | $ 7,495 | $ 9,246 |
| Income taxes paid (recovery) | $ (1,851) | $ 539 |

The accompanying notes are an integral part of the consolidated financial statements.

# Notes to the Consolidated Financial Statements

(in thousands of dollars, except per share or per unit information)

## 1. ORGANIZATION AND BASIS OF PRESENTATION

Exchange Income Corporation ("EIC" or the "Company") is a diversified, acquisition-oriented corporation focused on acquisition opportunities in the industrial products and aviation sectors, in particular businesses that are suited for public markets, except, in certain circumstances, for their size. The business plan of the Company is to invest in profitable, well-established companies with strong cash flows operating in niche markets in Canada and/or the United States.

The accompanying consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (GAAP), applied on a consistent basis, and includes the accounts of the Company and its wholly owned subsidiaries. The Company is considered a continuation of Exchange Industrial Income Fund (the "Fund") after converting to the Company pursuant to a plan of arrangement (the "Arrangement") as described below; as such, these consolidated financial statements follow the continuity of interests method of accounting in accordance with Emerging Issues Committee abstract 170, "Conversion of an Unincorporated Entity to an Incorporated Entity". Under the continuity of interests method of accounting, the transfer of the assets, liabilities and equity from the Fund to the Company are recorded at their net book values as at the effective date of the Arrangement. As a result of the application of the continuity of interests method of accounting, certain terms such as shareholder/unitholder, dividend/distribution and share/unit may be used interchangeably throughout these consolidated financial statements. For the periods reported up to the effective date of the Arrangement, all dividends/distributions to shareholders/unitholders were in the form of trust unit distributions.

As at December 31, 2010, the principal wholly-owned operating subsidiaries of the Company are Perimeter Aviation LP ("Perimeter"), Keewatin Air LP ("Keewatin"), 4873999 Manitoba Ltd., Calm Air International LP ("Calm Air"), 7328010 Canada Ltd., Jasper Tank Ltd. ("Jasper"), Overlanders Manufacturing LP ("Overlanders"), and Water Blast Manufacturing LP ("Water Blast"). Stainless Fabrication, Inc. ("Stainless") is a wholly owned subsidiary of Jasper. Through the Company's subsidiaries, products and services are provided in two business segments: Aviation and Manufacturing. On January 1, 2010, Water Blast BC was amalgamated with the Company but this amalgamation has no impact on operations of that entity.

As described in Note 27 – Subsequent Events, on January 1, 2011 the Company completed the acquisition of Bearskin Airlines ("Bearskin") which will be a principal wholly-owned operating subsidiary of the Company and added to the Aviation segment.

Also described in Note 27 is the announcement on March 9, 2011 that the Company has entered into a letter of intent to acquire Westower Communications ("Westower"). The structure of the purchased business is still being finalized but Westower will be a wholly-owned subsidiary and added to the Manufacturing segment.

**2009 Corporation Plan of Arrangement**

On July 28, 2009, the Fund converted to the Company pursuant to a plan of arrangement under the Canada Business Corporations Act through a reverse takeover by the Fund of HMY Airways Inc. ("HMY Airways"). Prior to the conversion, the consolidated financial statements included the accounts of the Fund and its subsidiaries. After giving effect to the Arrangement, the consolidated financial statements have been prepared on a continuity of interest basis, which recognizes the Company as the successor entity to the Fund. The continuity of interest basis requires that the comparative results within these consolidated financial statements are those previously presented by the Fund.

Effective on the closing of the Arrangement and related transactions, the Company now directly owns subsidiaries which own and operate the businesses which were held and operated by the Fund and its subsidiaries prior to the closing of the Arrangement. The directors of EIIF Management GP Inc. and management of the Fund prior to the Arrangement are now the directors and officers of the Company.

The Arrangement was approved at the special meeting of the holders ("Unitholders") of Class A trust units of the Fund ("Units") held on July 22, 2009, with 100% of the votes cast by Unitholders in favour of the Arrangement. On July 27, 2009, the Court of Queen's Bench of Manitoba granted the final order required in connection with the Arrangement.

Pursuant to the Arrangement, each Unitholder received one common share (a "Share") of the Company for each Unit held. After giving effect to the Arrangement, there were 9,980,723 Shares issued and outstanding.

The Company expensed costs of $2,655 during 2009 in relation to the conversion.

As part of the reverse takeover, the Company acquired certain assets of HMY Airways for consideration of $10,566, which consisted of cash of $9,566 and Shares of the Company with a value of $1,000 (102,446 Shares).

The Fund was an unincorporated open-ended mutual fund trust governed by the laws of the Province of Manitoba, created pursuant to a Declaration of Trust dated March 22, 2004. Each Unitholder participated pro rata in any distribution from the Fund. Income tax obligations related to distributions of the Fund were the obligation of the Unitholders.

## 2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements, expressed in thousands of Canadian dollars, have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and reflect the following significant accounting policies:

## Accounting Standards

The following are the accounting policies of the Company used in generating the consolidated financial statements and notes.

### a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries Perimeter, Keewatin, Calm Air, 4873999 Manitoba Ltd., 7328010 Canada Ltd., Jasper, Overlanders, and Water Blast, and their subsidiaries. All significant inter-company transactions have been eliminated for purposes of these consolidated financial statements.

### b) Revenue Recognition

The Company recognizes revenue principally on two types of transactions: provision of flight services in the Aviation segment and sales of manufacturing products in the Manufacturing segment.

The Company records flight revenue at the time when the flight has been completed. Tickets sold but for which the customer has not flown are reflected on the balance sheet as deferred revenue and recognized as flight revenue when the service is provided or when the ticket expires. The Company performs regular evaluations on the deferred revenue liability for passenger tickets purchased in advance within the Aviation segment's operating entities. These evaluations may result in adjustments being recognized as revenue. Due to the complexity of the pricing and systems, historical experience, and other factors including refunds, exchanges and unused tickets, certain amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates.

The Company recognizes manufacturing product revenue when the title has been passed to the customer, at the time the effective control of the product and the risks and rewards of ownership have been passed to the buyer, excluding revenues recognized by Stainless as described below on long-term contracts. Payments received in advance, including upfront non-refundable deposits, are recorded as deferred revenue until the product has been delivered to the customer.

Revenues from long-term contracts associated with manufacturing products from Stainless are recognized on a percentage-of-completion basis. The percentage complete is calculated based upon contract costs incurred to date compared with total estimated contract costs. The percentage complete is then applied to total anticipated contract revenue to determine the period's revenue. A provision for the estimated loss is made when contract costs are expected to exceed estimated contract revenue.

### c) Cash and Cash Equivalents

Cash and cash equivalents comprise cash and temporary investments consisting of highly liquid investments having a maturity of three months or less. Interest is recorded on an accrual basis. As at December 31, 2010, cash equivalents was nil (2009 – nil).

### d) Restricted Cash

Restricted cash is comprised of cash held in trust by legal counsel in preparation for the closing of the acquisition of Bearskin as further described in Note 27 – Subsequent Events.

e) Inventory

Raw material and parts inventories have been valued at the lower of cost and net realizable value. Work in progress and finished goods inventories have been valued at the lower of cost of materials and labour, plus systematically allocated overhead, and net realizable value. Inventory items previously written-down to net realizable value can be subsequently reversed back up to the original cost with an increase in the value of the inventory items.

The Company classifies its inventory into the following categories:

- Parts and other consumables: this includes the inventory of the Aviation segment subsidiaries and represents items utilized in the operations and repair of the aircraft.
- Raw materials: this includes items used in the manufacturing of products by the Manufacturing segment subsidiaries that have no labour work performed on them.
- Work in process: this includes items that have begun to be utilized in production by the Manufacturing segment subsidiaries.
- Finished goods: this includes items that have completed the manufacturing process and are available for sale or items purchased for resale by the Manufacturing segment subsidiaries, including consignment inventory held at certain entities in the Manufacturing segment.

f) Capital Assets

Capital assets are recorded at cost less accumulated amortization. Amortization of capital assets has been recorded on a straight-line basis using the following annual rates:

| | |
|---|---|
| Buildings | 4%–5% |
| Aircraft | 5%–40% |
| Equipment | 10%–20% |
| Other | 25%–30% |
| Leasehold improvements over the term of lease | |

g) Impairment of Long-Lived Assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recovered. An impairment loss is recognized when the carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is the excess of the carrying value of the asset over its fair value.

h) Intangible Assets

Intangible assets are recorded at cost. The Company has intangible assets with indefinite life which are not amortized. Intangible assets with finite lives are amortized as follows:

| | |
|---|---|
| Customer contracts | Pro rata based on expected revenues |
| Customer relationships | Pro rata based on expected revenues |
| Backlog | Pro rata based on expected revenues |
| Non-compete contracts | Straight-line over 5 years |
| Operating certificates | Straight-line over 2–30 years |
| Systems | Straight-line over 3–5 years |
| Other | Straight-line over 5 years |

The indefinite life intangible assets are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired.

i) Goodwill

Goodwill is recognized to the extent of the excess of the purchase price over the fair value of the underlying identifiable net assets acquired. Management reviews the carrying value of goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Any excess of carrying value over the fair value will be charged to income in the period in which the impairment is determined.

### j) Income Taxes

As a corporation, the Company utilizes the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using the enacted and substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect of a change in tax rates on future income tax assets and liabilities is recorded in net earnings in the period in which the change occurs. Unutilized tax loss carryforwards that are not more likely than not to be realized are reduced by a valuation allowance in the determination of future income tax assets.

Prior to the Company's conversion to a corporation, the Fund was a unit trust for income tax purposes and, as such, was only taxable on any taxable income not allocated to the unitholders. Income tax obligations relating to distributions from the Fund are obligations of the unitholders. Taxable income in the Fund's corporate subsidiaries are taxed at the applicable corporate income tax rate, while taxable income not allocated to the unitholders in the Fund entity is taxed at the highest personal income tax rate. The Fund accounted for income taxes using the asset and liability method of accounting for income taxes as described above.

### k) Overhaul Accrual

The Company accrues in the Aviation segment for the required cost of periodic overhauls to capital components of the aircraft based on the estimated cost to perform the overhaul and the flying hours before the overhaul is to be performed. Any variations between the amounts accrued and the actual cost for the overhaul is expensed in the period occurred.

### l) Pension Plan

As a result of the acquisition of Calm Air during 2009 (Note 4), the Company has pension-related costs associated with the defined contribution pension plan that certain Calm Air personnel are entered into. The Company's accounting policy is to expense contributions as earned during the period within general and administrative expenses within the Aviation segment. During 2010, the Company recorded pension plan costs of $624 (2009 over the period after the acquisition date – $412).

### m) Warrants

During the second quarter of 2009, the Company issued warrants for the first time within a public offering that closed in April 2009 and, subsequently, in a private placement that closed in June 2009 (Note 13). The warrants are presented separately as part of shareholders' equity and recorded at the consideration given, net of issuance costs. When warrants are exercised, the carrying value of the warrant is transferred to share capital within shareholders' equity. Any unexercised warrants that expire are reclassed to contributed surplus within shareholders' equity.

### n) Financial Instruments and Comprehensive Income

FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are initially recognized at fair value and subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the balance sheet and are measured at fair value with the exception of loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all unrealized gains and losses are included in net earnings in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet or deemed impaired.

The Company has classified its cash and cash equivalents and derivatives as held for trading. Accounts receivable and other receivables are classified as loans and receivables. Accounts payable and accrued expenses, long-term debt, convertible debentures, and debentures have been classified as other financial liabilities, all of which are measured at amortized cost.

The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration exchanged. Transaction costs and the related cash flow impacts are included in the fair value assessments of each financial asset and financial liability instrument. Subsequent to initial recognition, fair value is determined using generally accepted valuation techniques which refer to observable market data.

Transaction costs are included in the financial asset or liability and recognized over the life of the resulting instrument using the effective interest method. The transaction costs, which have been netted to long-term debt, convertible debentures, and debentures, are being amortized using the effective interest rate method over the life of the related debt. Any changes in the expected cash flows of those instruments result in a modification of the effective interest rate being used to amortize the carrying amount of the transaction costs over the remaining amended cash flows of the instrument from the date of the change. Any transaction costs associated with items classified as held for trading are expensed in the period incurred.

#### EMBEDDED DERIVATIVES

Derivatives may be embedded in other financial instruments (the "host instruments"). An embedded derivative has economic characteristics and risks that are not closely related to the economic characteristics and risks of the host instrument, and are measured at fair value with subsequent changes generally recognized in net earnings. This fair value measurement does not apply to derivatives that are recorded as equity.

#### COMPREHENSIVE INCOME

Comprehensive income is composed of the Company's net earnings and other comprehensive income. Other comprehensive income includes unrealized gains and losses on available-for-sale financial assets, foreign currency translation gains and losses on the net investment in self-sustaining operations and changes in the fair market value of derivative instruments designated as cash flow hedges, all net of income taxes. The components of comprehensive income are disclosed in the consolidated statements of comprehensive income.

#### HEDGE ACCOUNTING

The Company has no hedging arrangements where hedge accounting applies.

### o) Foreign Currency Translation

The Company translates the financial statements of Stainless, considered a self-sustaining US subsidiary, in accordance with the current rate method, under which assets and liabilities are translated at the currency exchange rate in effect at the balance sheet date, and earnings statement items are translated at the average currency exchange rate for the period. Translation adjustments arising from currency exchange rate fluctuations are recorded as a component of other comprehensive income and are shown in accumulated other comprehensive income under equity until realized, at which time they are transferred to income.

Monetary items and non-monetary items in a foreign currency outside of the Stainless investment are translated at the rate of exchange in effect at the balance sheet date. Non-monetary items are translated at the exchange rate in effect at the date of the transaction. Revenues and expenses are translated at the average rate of the period in which they were incurred. Foreign exchange gains and losses are included in earnings in the period they occur.

### p) Use of Estimates

The preparation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of collectibility of accounts receivable, value of work in progress and finished goods, revenue recognition measurements associated with long-term contracts and passenger revenues, valuation of intangibles and goodwill, impairment of assets, deferred revenue liabilities, provision for warranty, overhaul accrual rates, useful life for amortization, future income taxes and deferred tax credit. Results as determined by actual events could differ from these estimates.

q) Stock-Based Compensation

DEFERRED SHARE PLAN

Certain employees of the Company participate in a stock-based compensation plan of the Company's shares (Note 19). The plan consists of individuals being granted "deferred shares" which are essentially phantom shares that are tracked but not actually issued out of treasury or bought on the market until the time at which the deferred shares are redeemed. The deferred shares vest evenly over a three-year period. The participant has the ability to redeem the vested deferred shares for Company shares, cash or a combination of the two. As a result, this plan is accounted for under the liability method in that a liability is generated over the vesting period and the liability is revalued at each period-end based on the market price of the Company's shares at that time. Any changes in market value of the vested deferred shares liability is charged through compensation expense in that period. If the deferred shares are redeemed for Company shares, then the settlement of the liability is recorded as equity.

The dividend rate declared by the Company on issued Company shares is also applied on the deferred shares. The dividend amount on the deferred shares is converted into additional deferred shares based on the market value of the Company's shares at the time of the dividend. These additional deferred shares vest at the same time as the deferred shares that the dividend rate was applied on and the value is charged to compensation expense over the vesting period.

Any forfeited deferred shares are adjusted for as a recovery to compensation expense in the period of the forfeiture to the extent that the liability has been recognized.

EMPLOYEE SHARE PURCHASE PLAN

Certain employees of the Company participate in a stock based compensation plan of the Company's shares (Note 20). The fair value of shares to be awarded to employees is recognized as compensation expense on a straight-line basis over the applicable vesting period. For a share granted to an employee who is eligible to retire at the grant date, the fair value of the share is expensed on the grant date. For a share granted to an employee who will become eligible to retire during the vesting period, the fair value of the share is expensed over the period from the grant date to the date the employee becomes eligible to retire. Based on the history of previously vested programs, an estimate of forfeited shares is taken into consideration in valuing the liability recognized and is adjusted for differences between estimated forfeited shares and actual forfeitures at the end of the vesting period.

**Future Accounting Standards**

The following is an overview of accounting standard changes that the Company will be required to adopt in future years:

International Financial Reporting Standards

The Accounting Standards Board of Canada ("AcSB") has announced plans that will require the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") for publicly accountable enterprises, including the Company. The changeover date from Canadian GAAP to IFRS is for annual and interim financial statements relating to fiscal years beginning on or after January 1, 2011.

## 3. CORPORATE CONVERSION

As described above, on July 28, 2009, the Fund completed its conversion to the Company pursuant to the Arrangement. Effective on the closing of the Arrangement and related transactions, the Company now directly owns subsidiaries which own and operate the businesses which were held and operated by the Fund and its subsidiaries prior to the closing of the Arrangement. The directors of EIIF Management GP Inc. and management of the Fund prior to the Arrangement are now the directors and officers of the Company.

The Arrangement was approved at the special meeting of the holders ("Unitholders") of Class A trust units of the Fund ("Units") held on July 22, 2009, with 100% of the votes cast by Unitholders in favour of the Arrangement. On July 27, 2009, the Court of Queen's Bench of Manitoba granted the final order required in connection with the Arrangement.

Pursuant to the Arrangement, each Unitholder received one common share (a "Share") of the Company for each Unit held. After giving effect to the Arrangement, there were 9,980,723 Shares issued and outstanding.

The Company expensed costs of $2,655 during 2009 in relation to the conversion.

As part of the reverse takeover, the Company acquired certain assets of HMY Airways for consideration of $10,566, which consisted of cash of $9,566 and 102,446 Shares of the Company with a value of $1,000 (see Note 16).

## 4. ACQUISITIONS

The following acquisition was closed during the 2009 year:

### Acquisition of Calm Air

On April 8, 2009, the Company acquired 100% of the shares of A. Morberg Investment Corporation, the parent company of Calm Air International Ltd. ("Calm Air"). Calm Air is a regional airline carrier that provides both regularly scheduled and chartered passenger and cargo flights to 16 communities in Manitoba and Nunavut. The results of operations are included in the Company's consolidated statement of operations since the date of acquisition and is part of the Aviation segment.

The total consideration for the acquisition was $48,542 before acquisition costs. On closing of the transaction, the Company made a preliminary payment of $43,020 which was funded with a combination of gross proceeds from the Company's public offering that closed on April 7, 2009 (see Notes 10, 12–13) and a drawdown of the Company's amended bank credit facility (Note 9). The vendor also received 624,211 Shares of the Company valued at $5,930 based on the market value of the Company's shares around the time of the acquisition. The working capital adjustment was finalized before the end of the year resulting in the Company receiving a payment from the vendor of $408. The Company also assumed certain debt obligations of $7,462 (US$6,046) and paid certain other debt obligations of $2,888.

| | |
|---|---|
| Consideration given: | |
| Cash | $ 42,612 |
| Issue of 624,211 units of the Fund at a price of $9.50 per unit | 5,930 |
| Acquisition costs | 178 |
| Total purchase consideration | $ 48,720 |

The acquisition was accounted for using the purchase method. Details of the fair values of the net assets acquired at the time of the transaction are as follows:

| | |
|---|---|
| Fair value of assets acquired: | |
| Cash | $ 3,418 |
| Accounts receivable | 5,121 |
| Inventory | 5,476 |
| Prepaid expenses | 508 |
| Future income tax asset | 69 |
| Capital assets | 52,695 |
| Intangible assets | 5,803 |
| | 73,090 |
| Less fair value of liabilities assumed: | |
| Accounts payable and accrued liabilities | 6,621 |
| Deferred revenue | 5,598 |
| Overhaul accrual | 2,193 |
| Aircraft finance debt | 10,350 |
| Future income taxes | 7,395 |
| Fair value of identifiable net assets acquired | 40,933 |
| Goodwill | 7,787 |
| Total purchase consideration | $ 48,720 |

Of the $5,803 acquired intangible assets, $4,483 was assigned to brand names, $664 was assigned to operational certifications, $258 was assigned to existing contracts, $242 was assigned to customer relationships, and $156 was assigned to booked tickets. All the intangibles acquired are subject to amortization with the exception of the brand which is considered to have indefinite life.

None of the goodwill acquired is expected to be deductible for tax purposes.

### Bearskin Airlines & Westower Communications

As described in Note 27 – Subsequent Events, the Company completed the acquisition of Bearskin Airlines ("Bearskin") and on signed a letter of intent to acquire Westower Communications ("Westower") subsequent to December 31, 2010.

## 5. INVENTORY

The inventory of the Company's operating subsidiaries is classified into the following categories:

| | 2010 | 2009 |
|---|---|---|
| Parts and other consumables | $ 16,159 | $ 14,565 |
| Raw materials | 2,689 | 2,206 |
| Work in process | 1,078 | 374 |
| Finished goods | 8,343 | 10,089 |
| Total inventory | $ 28,269 | $ 27,234 |

During 2010, inventory with a value of $44,508 was recorded as direct operating expenses (2009 – $38,907).

## 6. CAPITAL ASSETS

| | | | 2010 |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value |
| Land | $ 706 | $ – | $ 706 |
| Buildings | 41,464 | 6,073 | 35,391 |
| Aircraft | 121,041 | 13,917 | 107,124 |
| Equipment | 22,796 | 9,564 | 13,232 |
| Other | 2,070 | 1,411 | 659 |
| Leasehold improvements | 1,968 | 641 | 1,327 |
| Balance, end of year | $ 190,045 | $ 31,606 | $ 158,439 |
| | | | 2009 |
| | Cost | Accumulated Amortization | Net Book Value |
| Land | $ 617 | $ – | $ 617 |
| Buildings | 32,976 | 4,439 | 28,537 |
| Aircraft | 85,752 | 9,499 | 76,253 |
| Equipment | 19,395 | 7,510 | 11,885 |
| Other | 1,731 | 1,120 | 611 |
| Leasehold improvements | 2,105 | 608 | 1,497 |
| Balance, end of year | $ 142,576 | $ 23,176 | $ 119,400 |

Depreciation for the 2010 year was $9,373 (2009 – $7,913).

During the 2009 year, a write-down for impairment of $553 was recorded against a certain building of the Aviation segment. See Note 18 for additional information.

## 7. INTANGIBLE ASSETS

| | Cost | Accumulated Amortization | Net Book Value |
|---|---|---|---|
| | | | 2010 |
| Indefinite Life Assets | | | |
| Brand name | $ 9,678 | $ – | $ 9,678 |
| Finite Life Assets | | | |
| Customer contracts | 628 | 455 | 173 |
| Customer relationships | 4,244 | 3,074 | 1,170 |
| Non-compete agreements | 403 | 112 | 291 |
| Certifications | 1,041 | 332 | 709 |
| Information technology systems | 1,011 | 651 | 360 |
| Other | 702 | 241 | 461 |
| Balance, end of year | $ 17,707 | $ 4,865 | $ 12,842 |

| | Cost | Accumulated Amortization | Net Book Value |
|---|---|---|---|
| | | | 2009 |
| Indefinite Life Assets | | | |
| Brand name | $ 9,678 | $ – | $ 9,678 |
| Finite Life Assets | | | |
| Customer contracts | 628 | 310 | 318 |
| Customer relationships | 4,367 | 2,655 | 1,712 |
| Non-compete agreements | 253 | 75 | 178 |
| Certifications | 1,034 | 157 | 877 |
| Information technology systems | 984 | 411 | 573 |
| Other | 256 | 221 | 35 |
| Balance, end of year | $ 17,200 | $ 3,829 | $ 13,371 |

Amortization for the 2010 year was $1,099 (2009 – $1,417).

## 8. GOODWILL

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of year | $ 40,446 | $ 35,284 |
| Goodwill from business acquisitions (Note 4) | – | 7,787 |
| Change in goodwill of self-sustaining foreign operations (Stainless) | (768) | (2,625) |
| Goodwill impairment | – | – |
| Balance, end of year | $ 39,678 | $ 40,446 |

As a result of the foreign currency accounting policy for the consolidation of Stainless as described in Note 2o), the goodwill recorded for Stainless (US $14,751) is valued at the period-end exchange rate. During 2010 the Canadian dollar strengthened and resulted in a decrease in the Canadian dollar equivalent of goodwill in the consolidated financial statements.

## 9. LONG-TERM DEBT

| | 2010 | 2009 |
|---|---|---|
| Revolving term facility | | |
| Canadian dollar amounts drawn | $ 46,000 | $ 18,500 |
| United States dollar amounts drawn (US $7,450 outstanding at both dates) | 7,410 | 7,797 |
| Total credit facility debt outstanding, principal value | 53,410 | 26,297 |
| Less: unamortized transaction costs | (310) | (726) |
| Less: unamortized discount on outstanding BA's | – | (124) |
| Net credit facility debt | 53,100 | 25,447 |
| Aircraft finance debt | – | 2,943 |
| Long-term debt balance | 53,100 | 28,390 |
| Less: current portion of Aircraft finance debt | – | (2,943) |
| Long-term debt balance | $ 53,100 | $ 25,447 |

### Credit Facility

The Company's senior debt consists of a revolving term facility with a syndicate of Canadian banks. The credit facility provides for an authorized three-year revolving debt facility (May 2013 maturity) and secured by a general security agreement over the assets of the Company, subject to customary terms, conditions, covenants, and other provisions for a corporation. The interest rate is determined by a pricing grid which is based on the Company's EBITDA to net senior debt ratio. The Company defines "EBITDA" as earnings before interest, income taxes, depreciation, amortization, other non-cash expenses such as unrealized foreign exchange gains or losses and asset impairment, and any unusual non-operating one-time items such as conversion costs. The Company has the ability to choose the base interest rate for the credit facility between Prime, Bankers Acceptances ("BA's"), London Inter Bank Offer Rate ("LIBOR") or a combination of these. The weighted average interest rate of the credit facility debt outstanding as at December 31, 2010 is 4.33%.

The syndicate consists of four banks that each contributes $26.5 million towards the Company's $106 million of credit available under the facility. The total syndicate facility includes a revolving operating line of credit up to a maximum of $5,000. At December 31, 2010, the operating line of credit was not drawn upon by the Company (2009 – nil).

During 2010 the Company's amount outstanding under the Canadian portion of the credit facility fluctuated based on the Company making payments against the amount outstanding with funds made available from the issuance of the Series H convertible debentures (Note 10), the exercising of warrants and cash flow generated from operations. The Company also withdrew funds throughout the year for various internal growth opportunities and prior to December 31, 2010 the Company withdrew funds that were held in trust for the acquisition of Bearskin that took place subsequent to year-end 2010.

Transaction costs incurred during the 2010 year totaled $2 and will be amortized over the remaining term of the facility at the time the costs were incurred (2009 – $634). Amortization of transaction costs included in interest expense for 2010 was $417 (2009 – $443).

Interest expense related to the credit facility recorded by the Company during the 2010 year was $2,336 (2009 – $2,728).
The principal payments in each of the next three years are: 2011 – nil, 2012 – nil, and 2013 – $53,410.

As described in Note 27 – Subsequent Events, the Company amended its credit facility.

### Aircraft Finance Debt

As part of the acquisition of Calm Air (Note 4) in 2009, the Company assumed US dollar debt with Credit Lyonnais in association with the financing of two aircraft that were purchased by Calm Air prior to the acquisition by the Company. The security provided includes two SAAB 340B Plus aircraft within the Calm Air fleet, a spare engine, certain spare parts and a guarantee by the aircraft manufacturer. One of the two aircraft financing debt matured during the fourth quarter of 2009. During the 2010 year the aircraft financing debt matured and the Company paid the remaining principal.

Interest expense related to the aircraft finance debt recorded by the Company during the 2010 year was $262 (2009 – $432).

## 10. CONVERTIBLE DEBENTURES

| Series – Year of Issuance | Maturity | Interest Rate | Conversion Price |
|---|---|---|---|
| Series B – 2005 | July 8, 2010 | 8.0% | $ 11.50 |
| Series C – 2005 | September 1, 2010 | 8.0% | $ 13.25 |
| Series D – 2006 | August 12, 2011 | 8.0% | $ 13.25 |
| Series F – 2009 | April 8, 2014 | 10.0% | $ 10.75 |
| Series G – 2009 | September 30, 2014 | 7.5% | $ 14.50 |
| Series H – 2010 | May 31, 2017 | 6.5% | $ 20.00 |

Summary of the debt component of the convertible debentures:

| | 2010 Balance, Beginning of Year | Debentures Issued | Accretion Charges | Debentures Converted | Repaid on Maturity | 2010 Balance, End of Year | 2009 Balance |
|---|---|---|---|---|---|---|---|
| Series B | $ 3,351 | $ – | $ 12 | $ (3,114) | $ (249) | $ – | $ 3,351 |
| Series C | 2,469 | – | 15 | (2,244) | (240) | – | 2,469 |
| Series D | 6,796 | – | 58 | (5,793) | – | 1,061 | 6,796 |
| Series F | 3,817 | – | 33 | (1,981) | – | 1,869 | 3,817 |
| Series G | 27,759 | – | 347 | (5,561) | – | 22,545 | 27,759 |
| Series H | – | 27,623 | 153 | – | – | 27,776 | – |
| | | | | | | 53,251 | 44,192 |
| Less: unamortized transaction costs | | | | | | (2,738) | (2,281) |
| Convertible Debentures – Debt Component, end of year | | | | | | 50,513 | 41,911 |
| Less: current portion | | | | | | (1,052) | (5,761) |
| Convertible Debentures – Debt Component (long-term portion) | | | | | | $ 49,461 | $ 36,150 |

During the 2010 year convertible debentures totaling a face value of $19,408 were converted at various times into 1,499,096 Shares of the Company (2009 – $706 face value into 78,317 Shares). Interest expense recorded during the 2010 year for the convertible debentures was $5,387 (2009 – $2,736).

### Series A – D Convertible Debentures

As scheduled, in May 2009, the Series A convertible debentures matured and the Company paid $812 in cash for the outstanding debentures principal at maturity. The remaining equity component for the Series A convertible debentures at maturity of $61 was transferred to contributed surplus.

As scheduled, in July 2010, the Series B convertible debentures matured and the Company paid $249 in cash for the outstanding debentures principal at maturity. The remaining equity component for the Series B convertible debentures at maturity of $23 was transferred to contributed surplus.

As scheduled, in September 2010, the Series C convertible debentures matured and the Company paid $240 in cash for the outstanding debentures principal at maturity. The remaining equity component for the Series C convertible debentures at maturity of $18 was transferred to contributed surplus.

The Series D convertible debentures that are outstanding are convertible, at the option of the holders, into shares of the Company at a predetermined conversion price per share. The Company has the option to settle all or a portion of these convertible debentures obligations at their maturities through the issuance of shares at a price based on the weighted average 20 day trading price of the shares prior to the debentures maturity. The Series D convertible debentures have $1,075 of principal outstanding as at December 31, 2010 and mature in August 2011.

## Series F Convertible Debenture Offering

During 2009, the Company closed a public offering that included the issuance of $4,102 of Five Year 10% Series F Subordinate Secured Convertible Redeemable Debentures. These debentures bear interest at the rate of 10% per annum payable semi-annually in arrears, in cash, on the six-month and twelve-month anniversaries of the initial date of issuance. The maturity of the debentures is April 8, 2014. Each debenture is convertible, at the debenture-holders' option, into Shares of the Company at any time prior to the close of business on the day prior to the maturity date. At the Company's option, on the maturity date, the debentures (or any portion thereof) shall be convertible into Shares at the Company's forced conversion price equal to 95% of the weighted average trading price of the Shares for the 20 trading days prior to the maturity date. The Company also has the ability to redeem these Series F debentures, in whole or in part, on or after the third anniversary of the date of issuance of the debentures provided that certain thresholds are met surrounding the weighted average market price of the Shares at that time. Transaction costs of $475 were incurred during the 2009 year in relation to the issuance of the Series F debentures.

The Series F convertible debentures have $1,974 of principal outstanding as at December 31, 2010 and mature in April 2014.

## Series G Convertible Debenture Offering

During 2009, the Company closed a public offering that included the issuance of $30,000 of Five Year 7.5% Series G Subordinate Secured Convertible Redeemable Debentures. These debentures bear interest at the rate of 7.5% per annum payable semi-annually in arrears, in cash, on the six-month and twelve-month anniversaries of the initial date of issuance. The maturity of the debentures is September 30, 2014. Each debenture is convertible, at the debenture-holders' option, into Shares of the Company at any time prior to the close of business on the day prior to the maturity date. At the Company's option, on the maturity date, the debentures (or any portion thereof) shall be convertible into Shares at the Company's forced conversion price equal to 95% of the weighted average trading price of the Shares for the 20 trading days prior to the maturity date. The Company also has the ability to convert these Series G debentures, in whole or in part, on or after the third anniversary of the date of issuance of the debentures provided that certain thresholds are met surrounding the weighted average market price of the Shares at that time. Transaction costs of $1,654 were incurred during the 2009 year in relation to the issuance of the Series G debentures.

The Series G convertible debentures have $24,034 of principal outstanding as at December 31, 2010 and mature in September 2014.

## Series H Convertible Debenture Offering

On April 30, 2010, the Company closed a public offering that included the issuance of $30,000 of Seven Year 6.5% Series H Subordinate Secured Convertible Redeemable Debentures. These debentures bear interest at the rate of 6.5% per annum payable semi-annually in arrears, in cash, on May 31 and November 30 of each year. The maturity of the debentures is May 31, 2017. Each debenture is convertible, at the debenture-holders' option, into Shares of the Company at any time prior to the close of business on the day prior to the maturity date at a conversion price is $20.00. At the Company's option, on the maturity date, the debentures (or any portion thereof) shall be convertible into Shares at the Company's forced conversion price equal to 95% of the weighted average trading price of the Shares for the 20 trading days prior to the maturity date. The Company also has the ability to convert these Series G debentures, in whole or in part, on or after the third anniversary of the date of issuance of the debentures provided that certain thresholds are met surrounding the weighted average market price of the Shares at that time. After May 31, 2013, but prior to May 31, 2015, the Company has the option to redeem these debentures provided that certain thresholds are met surrounding the weighted average market price of the Shares at that time. On and after May 31, 2015 but prior to the maturity date the Company has the option to redeem these debentures without any weighted average market price thresholds. If the Company elects to redeem the debentures, the debentureholders have the option to convert the debentures into Shares of the Company at the conversion price. Transaction costs of $1,570 were incurred during the 2010 year in relation to the issuance of the Series H debentures.

The Series H convertible debentures have $30,000 of principal outstanding as at December 31, 2010 and mature in May 2017.

### Series I Convertible Debenture Offering

As described in Note 27 – Subsequent Events, the Company closed the bought deal offering of $35,000 principal amount in five-year 5.75% Series I convertible senior secured debentures with a $26.00 conversion price on January 11, 2011.

Since all of the outstanding convertible debentures contain a conversion feature available to the debenture-holder to convert debenture principal into Shares of the Company, the debenture obligation is classified partly as debt and partly as shareholders' equity. The debt component represents the present value of interest and principal payments over the life of the convertible debentures discounted at a rate approximating the rate which would have been applicable to non-convertible secured debentures at the time the convertible debentures were issued. The difference between the principal amount of the convertible debentures and the present value of interest and principal payments over the life of the convertible debentures is accreted over the term of the convertible debentures through periodic charges to the debt component, such that, on maturity, the debt component equals the principal amount of the convertible debentures outstanding. Summary of the equity component of the convertible debentures:

| | 2010 | 2009 |
|---|---|---|
| Series B – 2005 | $ – | $ 261 |
| Series C – 2005 | – | 193 |
| Series D – 2006 | 83 | 541 |
| Series F – 2009 | 145 | 301 |
| Series G – 2009 | 1,879 | 2,345 |
| Series H – 2010 | 2,377 | – |
| Convertible Debentures – Equity Component, end of year | $ 4,484 | $ 3,641 |

The convertible debentures are secured, subordinate only to senior security, by a charge on the assets and undertakings of the Company and its subsidiaries.

## 11. DEBENTURES

### Series E Debentures

The debentures bear interest at a rate of 9.0% per annum payable semi-annually, mature in five years from the first closing date and contain no conversion terms into shares of the Company. The debentures are secured, subordinate only to senior security, by a charge on the assets and undertakings of the Company and its subsidiaries.

On December 21, 2009, the Company announced the planned early redemption of all 9,691 Series E debentures ($9,691 face value). Effective January 25, 2010, the Company paid $10,179, consisting of a redemption price of 101% of the principal amount of each Series E debenture plus all accrued and unpaid interest up to but excluding that effective date. Interest on the debentures ceased to be payable from and after the effective date. Interest expense of $64 was recorded during 2010 for the period up to the redemption date (fiscal 2009 – $1,732).

## 12. SHARE CAPITAL

As described above, the Units outstanding of the Fund at the time of the conversion to a corporation were exchanged for Shares of the Company on a one-to-one basis.

Changes in the Shares issued and outstanding during the 2010 year are as follows:

| | 2010 | |
|---|---|---|
| | Number of shares | Amount |
| Share capital, beginning of year | 10,780,704 | $ 104,451 |
| Issued from warrants exercised (Note 13) | 2,096,631 | 21,763 |
| Issued under dividend reinvestment plan (DRIP) | 115,995 | 1,746 |
| Issued upon conversion of convertible debentures | 1,499,096 | 19,749 |
| Issued as payment to TCIG | 26,416 | 337 |
| Share capital, end of year | 14,518,842 | $ 148,046 |

Changes in the Shares issued and outstanding during the 2009 comparative year are as follows:

| | 2009 | |
|---|---|---|
| | Number of shares | Amount |
| Share capital, beginning of year | – | $ – |
| Issued to trust unitholders pursuant to Plan of Arrangement (Note 3) | 9,878,277 | 95,183 |
| Issued for purchase consideration in part with Plan of Arrangement (Note 3) | 102,446 | 1,000 |
| Issued from warrants exercised (Note 13) | 725,551 | 7,521 |
| Issued under the Employee Share Purchase Plan (Note 20) | 59,564 | 714 |
| Issued for First Nations Community Partnership Agreements | 7,000 | 68 |
| Issued under dividend reinvestment plan (DRIP) | 7,215 | 87 |
| Issued upon conversion of convertible debentures | 651 | 6 |
| Issuance costs | – | (128) |
| Share capital, end of year | 10,780,704 | $ 104,451 |

Changes in the Units issued and outstanding during the 2009 comparative years are as follows:

| | 2009 | |
|---|---|---|
| | Number of units | Amount |
| Trust units, beginning of year | 5,872,464 | $ 59,495 |
| Issued for cash and vendor note settlement through public offering (net of issuance costs and taxes of $739) | 2,398,554 | 21,088 |
| Issued for cash through private placement (net of issuance costs and taxes of $423) | 835,810 | 7,183 |
| Issued for purchase consideration (Note 4) | 624,211 | 5,930 |
| Issued upon conversion of convertible debentures | 77,666 | 741 |
| Issued as payment to TCIG | 66,072 | 710 |
| Issued from warrants exercised (Note 13) | 3,500 | 36 |
| Decrease resulting from implementation of Plan of Arrangement (Note 3) | (9,878,277) | (95,183) |
| Trust units, end of year | – | $ – |

During both 2010 and 2009, amounts earned by the Tribal Councils Investment Group ("TCIG"), a related party of the Company, were paid in Shares of the Company in accordance with the marketing agreement between the parties (Note 25).

The Company closed a public offering in April 2009 and a private placement in June 2009. Both included the issuance of Shares of the Company that totaled gross proceeds of $29,433 (overall, 3,234,364 Shares were issued with a per Share value of $9.10). Total issuance costs of $1,539 (before tax of $249) were incurred during the 2009 year in relation to the closing of both issuances of Shares. Within the April 2009 public offering, the Company issued 213,831 Shares of the Company as full settlement of the Stainless vendor note payable (US $1,640).

Associated with the acquisition of Calm Air during 2009, the Company issued 624,211 Shares as part of the consideration given to the vendor with a value of $5,930 (Note 4). Associated with the conversion to a corporation during the third quarter of 2009, the Company issued 102,446 Shares as part of the consideration given to the vendor of HMY Airways with a value of $1,000 (Note 3).

## 13. WARRANTS

During the 2009 year, the Company closed a public offering in April 2009 and a private placement in June 2009. Both included the issuance of warrants. Each warrant entitles the holder thereof to purchase one Share of the Company at a price of $10.00 per Share for a period of two years from the date of issuance of the warrant. A warrant does not give its holder any voting right or other right attaching to the Shares of the Company until the warrants are properly exercised and Shares issued.

A total of 3,234,364 warrants were issued during the second quarter of 2009 with a per warrant value of $0.40, and total issuance costs of $64 were incurred in relation to the closing of both issuances of warrants. The fair value of the warrants issued was determined using the Black-Scholes Option Pricing Model.

Changes in the warrants issued and outstanding during the 2010 year are as follows:

| | | | 2010 |
|---|---|---|---|
| | Date issued | Number of warrants | Amount |
| Warrants outstanding, beginning of year | | 2,505,313 | $ 952 |
| Warrants exercised | various | (2,096,631) | (797) |
| Warrants outstanding, end of year | | 408,682 | $ 155 |

Changes in the warrants issued and outstanding during the 2009 year are as follows:

| | | | 2009 |
|---|---|---|---|
| | Date issued | Number of warrants | Amount |
| Warrants outstanding, beginning of year | | – | $ – |
| Issued for public offering | April 7, 2009 | 2,398,554 | 918 |
| Issued for private placement | June 22, 2009 | 835,810 | 311 |
| Warrants exercised | various | (729,051) | (277) |
| Warrants outstanding, end of year | | 2,505,313 | $ 952 |

During 2010 a total of $21,763 (2009 – $7,557) was transferred to share capital for the warrants exercised which includes the $10.00 exercise price per warrant. The warrants outstanding as at December 31, 2010 expire in the second quarter of 2011 (318,259 in April and 90,423 in June).

## 14. CAPITAL MANAGEMENT

The Company manages its capital to utilize prudent levels of debt. The Company maintains its level of senior debt within a range of 1.5 – 2.5 times funded senior debt to proforma earnings before interest, income taxes, depreciation, amortization and other non-cash items.

The Company's objective in managing capital is to:

- ensure flexibility in the capital structure to fund the operations, distributions to shareholders, the capital investments and to support the external growth strategy;
- maintain adequate liquidity at all times; and
- maintain a diversified capital structure.

The Company actively manages and monitors the capital structure and makes adjustments based on the objectives described above in response to changes in economic conditions and the risk characteristics of the underlying assets.

The following is considered by the Company as capital and may not be comparable to measures presented by other public companies:

| | 2010 | 2009 |
|---|---|---|
| Total senior debt outstanding, principal value | $ 53,410 | $ 29,240 |
| Convertible debentures outstanding, face value | 57,083 | 46,980 |
| Debentures outstanding, face value | – | 9,691 |
| Shares | 148,046 | 104,451 |
| Warrants | 155 | 952 |
| Total capital, end of year | $ 258,694 | $ 191,314 |

The Company considers the existing level of equity capital to be adequate in the context of current operations and the Company's strategic plan. The Company expects that its dividends to its shareholders during 2011 will be funded by earnings and operating cash flows generated by its operating subsidiaries.

There are certain capital requirements of the Company resulting from the Company's credit facility that includes financial covenants and ratios, including leverage ratios that assess the funded senior debt to adjusted earnings before interest, income tax expense, depreciation, amortization and other non-cash items ("EBITDA") ratio. Management uses these capital requirements in the decisions made in managing the level and make-up of the Company's capital structure. The Company has been in compliance with all of the financial covenants during the 2010 period.

Changes in the capital of the Company over the 2010 period are mainly attributed to the redemption of the Series E debentures funded through the Company's credit facility, the conversion to shares of convertible debentures, the exercising of warrants into shares and the issuance of Series H convertible debentures.

## 15. DIVIDENDS AND DISTRIBUTIONS DECLARED

The Company's policy is to make dividends to shareholders equal to cash flows from operations after making allowances for debt servicing requirements, working capital, and for growth and capital expenditure requirements as deemed prudent by its board of directors.

Cumulative dividends/distributions during the 2010 and comparative 2009 years are as follows:

| | 2010 | 2009 |
|---|---|---|
| Cumulative dividends / distributions, beginning of year | $ 35,601 | $ 21,541 |
| Distributions during the year | – | 7,257 |
| Dividends during the year | 20,342 | 6,803 |
| Cumulative dividends / distributions, end of year | $ 55,943 | $ 35,601 |

The amounts and record dates of the dividends/distributions during the 2010 and comparative 2009 years are as follows:

| | 2010 Dividends | | | 2009 Dividends | | |
|---|---|---|---|---|---|---|
| Month | Record date | Per share | Amount | Record date | Per share | Amount |
| January | January 29, 2010 | $ 0.13 | $ 1,418 | | $ – | – |
| February | February 26, 2010 | 0.13 | 1,487 | | – | – |
| March | March 31, 2010 | 0.13 | 1,545 | | – | – |
| April | April 30, 2010 | 0.13 | 1,614 | | – | – |
| May | May 31, 2010 | 0.13 | 1,691 | | – | – |
| June | June 30, 2010 | 0.13 | 1,701 | | – | – |
| July | July 30, 2010 | 0.13 | 1,714 | | – | – |
| August | August 31, 2010 | 0.13 | 1,754 | August 31, 2009 | 0.13 | 1,318 |
| September | September 30, 2010 | 0.13 | 1,802 | September 30, 2009 | 0.13 | 1,323 |
| October | October 31, 2010 | 0.13 | 1,849 | October 30, 2009 | 0.13 | 1,372 |
| November | November 30, 2010 | 0.13 | 1,879 | November 30, 2009 | 0.13 | 1,389 |
| December | December 30, 2010 | 0.13 | 1,888 | December 31, 2009 | 0.13 | 1,401 |
| Total | | $ 1.56 | $ 20,342 | | $ 0.65 | $ 6,803 |
| | 2010 Distributions | | | 2009 Distributions | | |
| Month | Record date | Per unit | Amount | Record date | Per unit | Amount |
| January | | $ – | $ – | January 30, 2009 | $ 0.13 | $ 776 |
| February | | – | – | February 27, 2009 | 0.13 | 777 |
| March | | – | – | March 31, 2009 | 0.13 | 778 |
| April | | – | – | April 30, 2009 | 0.13 | 1,174 |
| May | | – | – | May 29, 2009 | 0.13 | 1,184 |
| June | | – | – | June 30, 2009 | 0.13 | 1,284 |
| July | | – | – | July 28, 2009 | 0.13 | 1,284 |
| Total | | $ – | $ – | | $ 0.91 | $ 7,257 |

## 16. INCOME TAXES

On July 28, 2009, the Company converted from a publicly traded income trust to a publicly traded corporation by way of a plan of arrangement with HMY Airways Inc. for cash and share consideration of $10,566. As a result of the arrangement, the Company recorded a deferred credit of $42,257 relating to the difference between the future income tax asset of $52,823 and the amount paid to the controlling shareholder of HMY Airways Inc. The accounting for the deferred credit is in accordance with the CICA's Emerging Issues Committee abstract 110 – "Accounting for Acquired Future Tax Benefits in Certain Purchase Transactions that are not Business Combinations", the credit is being amortized to income tax expense in proportion to the net reduction in the future income tax asset that gave rise to the deferred credit.

Prior to July 28, 2009, the Company was a grandfathered Specified Investment Flow Through and was not subject to tax during this time as its income was taxed at the unitholder level.

The future income tax of the Company relate to the following items:

| | 2010 | 2009 |
|---|---|---|
| Future income tax assets – current | | |
| Capital and non-capital loss carryforwards | $ 5,910 | $ 4,331 |
| Accruals – deductible when paid | 244 | 229 |
| Total future income tax asset – current | $ 6,154 | $ 4,560 |
| Future income tax assets – long-term | | |
| Capital assets | $ (15,244) | $ (12,348) |
| Intangible assets | (987) | (740) |
| Financing costs | 438 | 712 |
| Accruals – deductible when paid | 3,006 | 2,051 |
| Deferred compensation plans | 289 | 116 |
| Capital and non-capital loss carryforwards | 41,105 | 45,118 |
| Other comprehensive income | (8) | (77) |
| Other | 71 | 12 |
| Future income tax asset – long-term | 28,670 | 34,844 |
| Valuation allowance | (226) | (226) |
| Total future income tax asset – long-term | $ 28,444 | $ 34,618 |
| Future income tax liabiility – long-term | | |
| Capital assets | – | (946) |
| Intangible assets | – | 351 |
| Financing costs | – | (5) |
| Other | | (38) |
| Total future income tax liability – long-term | $ – | $ (638) |

A reconciliation of the deferred credit is as follows:

| | 2010 | 2009 |
|---|---|---|
| Deferred credit – beginning of year | $ 39,655 | $ – |
| Deferred credit recorded upon corporate reorganization | – | 42,257 |
| Amortization during the year | (3,241) | (2,602) |
| Deferred credit – end of year | 36,414 | 39,655 |
| Less: current portion | (4,700) | (3,464) |
| Deferred credit | $ 31,714 | $ 36,191 |

As at December 31, 2010, the Company had non-capital loss carryforwards available to reduce future years' taxable income, which expire as follows:

| | Non-capital Loss Carryforwards |
|---|---|
| Year of expiry | |
| 2013 | $ 16,524 |
| 2014 | 26,476 |
| 2024 and beyond | 129,617 |
| | $ 172,617 |

The effective income tax rate for the Company is determined as follows:

| | 2010 | 2009 |
|---|---|---|
| Earnings before provision for income taxes | $ 13,931 | $ 13,593 |
| Combined Canadian federal and provincial tax rates | 30.0% | 31.3% |
| Income tax expense at statutory rates | 4,179 | 4,250 |
| Increase (decrease) in taxes resulting from: | | |
| Trust income allocated to unitholders prior to conversion | – | (1,932) |
| Permanent differences | 430 | 341 |
| Impact of amortization of deferred tax credit | (3,242) | (2,602) |
| Impact of conversion from trust to corporation | – | (315) |
| Change in effective rate | (129) | 781 |
| Impact of foreign currency rate differential | (169) | – |
| Valuation allowance | – | 226 |
| Capital gains | – | (163) |
| Other | (32) | 18 |
| Provision (recovery) for income taxes | $ 1,037 | $ 604 |

## 17. EARNINGS PER SHARE

The computation for basic and diluted earnings per share for the 2010 and comparative 2009 years are as follows:

| | 2010 | 2009 |
|---|---|---|
| Net earnings for the year | $ 12,894 | $ 12,989 |
| Dilutive effect of convertible debentures | 5,051 | 2,644 |
| Add back impact from anti-dilutive factors | (4,977) | – |
| Dilutive effect of warrants | – | – |
| Diluted earnings for the year | $ 12,968 | $ 15,633 |
| Basic weighted average number of shares | 12,885,765 | 8,835,870 |
| Dilutive effect of convertible debentures | 3,784,504 | 1,985,462 |
| Add back impact from anti-dilutive factors | (3,702,957) | – |
| Dilutive effect of warrants | 365,844 | 385,790 |
| Diluted basis average number of shares | 13,333,156 | 11,207,122 |
| Earnings per share: | | |
| Basic | $ 1.00 | $ 1.47 |
| Diluted | $ 0.97 | $ 1.39 |

As a result of the one-to-one conversion of Units of the Fund, to Shares of the Company (Note 1), there is no impact of the conversion on the earnings per share calculations as the Units of the Fund are directly comparable to the Shares of the Company. As a result, the calculations for the periods before the conversion are presented as earnings per share.

## 18. SEGMENTED INFORMATION

The Company's reportable business segments are strategic business units that offer different products and services. The Company has two reportable business segments: Aviation and Manufacturing. The Aviation segment provides airline services to communities in Manitoba and Nunavut. The Manufacturing segment consists of niche specialty metal manufacturers in markets throughout Alberta, British Columbia and the United States. During the second quarter of 2009, the Company acquired Calm Air and results for Calm Air since the acquisition date are included in the Aviation segment. Subsequent to 2010, the Company acquired Bearskin that will be added to the Aviation segment and Bearskin's main operations are in Ontario.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates each segment's performance based on EBITDA. The Company's method of calculating EBITDA may differ from that of other corporations or of income funds and therefore may not be comparable to measures utilized by them. There are no inter-segment revenues, and segment revenues presented in the tables below are from external customers.

The Company used in the following segment tables is not a separate segment and is only presented to reconcile to enterprise revenues, EBITDA, total assets, capital asset additions and goodwill. It includes expenses incurred at head office.

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Aviation | Manufacturing | Company | Consolidated | Aviation | Manufacturing | Company | Consolidated |
| Revenue | $ 189,321 | $ 55,373 | $ – | $ 244,694 | $ 153,480 | $ 57,771 | $ – | $ 211,251 |
| EBITDA | 31,802 | 6,954 | (6,351) | 32,405 | 31,075 | 6,894 | (5,238) | 32,731 |
| Interest expense | | | | 8,057 | | | | 7,652 |
| Amortization of intangible assets | | | | 1,099 | | | | 1,417 |
| Depreciation | | | | 9,373 | | | | 7,913 |
| Conversion costs | | | | – | | | | 2,655 |
| Foreign exchange (gains)/losses on debt | | | | (55) | | | | (1,052) |
| Impairment loss | | | | – | | | | 553 |
| Earnings before tax | | | | $ 13,931 | | | | $ 13,593 |

During the 2009 year, the Company decided to construct a new terminal building for one of the entities in the Aviation segment as the existing building was not sufficient any longer and modifications to the existing building would not be adequate. As a result, the building is being demolished and the carrying value of the building of $553 ($404 after-tax) was recorded by the Company as an impairment loss in the period.

The following is the geographic breakdown of revenues for the 2010 and comparative 2009 years, based on location of the customer, and the capital assets and goodwill as at the balance sheet dates:

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Aviation | Manufacturing | Company | Consolidated | Aviation | Manufacturing | Company | Consolidated |
| Total assets | $ 183,563 | $ 46,223 | $ 107,221 | $ 337,007 | $ 172,102 | $ 60,307 | $ 35,400 | $ 267,809 |
| Net capital asset additions | 44,860 | 1,392 | 41 | 46,293 | 10,738 | 655 | 159 | 11,552 |
| Goodwill | 13,435 | 26,243 | – | 39,678 | 13,435 | 27,011 | – | 40,446 |

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Capital Assets | Goodwill | Capital Assets | Goodwill |
| Canada | $ 155,770 | $ 25,007 | $ 116,167 | $ 25,007 |
| United States | 2,669 | 14,671 | 3,233 | 15,439 |
| | $ 158,439 | $ 39,678 | $ 119,400 | $ 40,446 |

As a result of the foreign currency policy for the consolidation of Stainless, the goodwill recorded for Stainless (US $14,751) is valued at the period-end exchange rate and as a result fluctuates as the Canadian dollar reporting currency changes in comparison to the US dollar.

## 19. DEFERRED SHARE PLAN

The number of deferred shares granted under the Deferred Share Plan were as follows:

| | 2010 | 2009 |
|---|---|---|
| Deferred shares outstanding, beginning of year | 45,822 | 22,719 |
| Granted during the year | 27,612 | 17,421 |
| Granted through dividends/distributions declared during the year | 7,279 | 5,682 |
| Deferred shares outstanding, end of year | 80,713 | 45,822 |
| Vested portion of deferred shares outstanding, end of year | 32,418 | 14,014 |
| Fair value of liability recorded on vested deferred shares, end of year | $ 1,070 | $ 430 |

The fair value of the deferred shares granted during the 2010 year was $385 at the time of the grant (2009 – $166). During the 2010 year, the Company recorded net compensation expense of $640 for the Deferred Share Plan within the general and administrative expenses of head-office (2009 – net compensation expense of $295).

## 20. EMPLOYEE SHARE PURCHASE PLAN

Certain employees of the Company participate in an Employee Share Purchase Plan (“ESPP”). Under the ESPP, employees make contributions of up to 5% of their base salaries to purchase Company shares out of Treasury, and upon the employees remaining employed with the Company or its subsidiaries during an 18-month vesting period, they are entitled to receive an additional number of shares (“additional shares”) equal to 33.3% of the number of shares they purchased and dividends declared on those additional shares over the vesting period.

At the decision of the employee, any dividends paid on the additional shares over the vesting period are either paid to the employee upon the shares vesting or shares are purchased using these dividend funds.

The plan is offered to employees annually and in November 2010 a total of 51,872 of Shares of the Company were purchased for the 2010 program that will vest in 18 months (May 2012). The fair value of the additional shares that will be awarded upon the vesting conditions of the plan being attained is estimated at $339 based on the share price and monthly dividend rate as at that time. The cost of the award is recognized in head-office expenses of the Company over the 18 month vesting period beginning in December 2010.

During 2009, 59,564 shares were issued out of Treasury, effective November 13, 2009 for the 2009 program that will vest in 18 months (May 2011). The fair value of the additional shares that will be awarded upon the vesting conditions of the plan being attained is estimated at $285 based on the share price and monthly dividend rate as at that time. The cost of the award is recognized in head-office expenses of the Company over the 18 month vesting period beginning in December 2009.

Over the amortization period as the plans reach the end of the 18 month vesting period, the liability associated with the award is adjusted for changes in the Company’s share price at the period-end, any changes in the Company’s dividend rate and any known forfeitures. During 2010, total expenses incurred in head-office expenses was $263 (2009 – $126).

## 21. CHANGES IN WORKING CAPITAL ITEMS

The changes in non-cash operating working capital items during the 2010 and comparative 2009 years are as follows:

| | 2010 | 2009 |
|---|---|---|
| Accounts receivable | $ (9,354) | $ 7,161 |
| Inventory | (1,035) | 3,015 |
| Prepaid expenses | (1,408) | (860) |
| Accounts payable and accrued charges | 9,179 | (87) |
| Deferred revenue | 1,193 | (3,179) |
| Foreign currency adjustments | (338) | (621) |
| Net change in working capital items | $ (1,763) | $ 5,429 |

## 22. COMMITMENTS

The Company and its subsidiaries rent premises and equipment under operating lease agreements. The minimum lease payments under these contractual obligations as at December 31, 2010 are as follows:

| | Commitments |
|---|---|
| 2011 | $ 3,792 |
| 2012 | 1,999 |
| 2013 | 1,238 |
| 2014 | 994 |
| 2015 | 700 |
| Thereafter | 6,267 |
| | $ 14,990 |

Included in the table above are commitments obligated to related parties in association with leased property used in the operations of Water Blast for $821 and Stainless for $716 (US $720), both of which are described further in Note 25.

## 23. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

### Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of currency, interest rate and other price risk.

**Currency Risk**

As part of the acquisition of Calm Air in April 2009 the Company assumed certain aircraft finance debt denominated in US dollars ("USD"). During the first quarter of 2010 the Company entered into a USD forward rate contract for US $2,400 that matched the majority of the USD principal that was paid by the Company during the remainder of 2010. The Company recorded a net foreign exchange gain of $55 during 2010 between the maturity value of the USD forward rate contract and the conversion of the US dollar based aircraft finance debt that matured during the fourth quarter of 2010. As at December 31, 2010, there is no remaining balance owing for the aircraft finance debt (2009 – US $2,812).

During the 2009 year, the Company recorded a net foreign exchange gain on debt of $1,052 relating to the revaluation of the US denominated aircraft finance debt assumed by the Company with the acquisition of Calm Air. An unrealized portion was recorded of $541 relating to the revaluation of the USD aircraft finance debt outstanding and is based on the change in exchange rates between the end of period and the rate at the acquisition date. A realized portion was recorded of $511 relating to the aircraft finance debt paid during 2009 and is based on the change of the exchange rate between the time of the payments and the acquisition date.

The Company has US $7,450 outstanding on its credit facility ($7,410). The outstanding funds in USD results in currency risk that the future cash flows will fluctuate with the changes in market currency rates. The exposure for the USD portion of its credit facility outstanding is offset by the cash generated through the operations of its Manufacturing segment subsidiaries, in particular, the operations of Stainless throughout the United States. The Company has no outstanding derivative instruments to reduce its exposure to the currency risk.

The Company also recorded a currency translation loss of $688 (2009 – loss of $2,787) in Other Comprehensive Income as described below in Note 26.

A $0.01 weakening in the value of the Canadian dollar in relation to the US dollar applied to the Company's financial instruments outstanding at December 31, 2010 would have a negative impact of approximately $0.1 million on future net earnings and decrease the foreign currency translation adjustment in Other Comprehensive Income by approximately $0.1 million.

**Interest Rates**

The Company is subject to the risk that future cash flows associated with the credit facility outstanding (Note 9) will fluctuate due to fluctuations in interest rates and the degree of volatility of the rates. The Company manages this risk and seeks financing terms in individual arrangements that are most advantageous. The Company has not used derivative instruments to mitigate this risk.

The terms of the credit facility allow for the Company to choose the base interest rate between Prime, Bankers Acceptances or London Inter Bank Offer Rate ("LIBOR"). At December 31, 2010, $46,000 was outstanding under Canadian Prime and US $7,450 was outstanding under US LIBOR.

Based on the outstanding credit facility at December 31, 2010, net of cash and cash equivalents, a 1% increase in interest rates for the Company would decrease net earnings for the next fiscal year by approximately $520 ($484 after-tax).

The interest rates of the convertible debentures (Note 10) have fixed interest rates.

## Credit Risk

Credit risk arises from the potential that a counterparty will fail to perform its obligations. In addition, the Company is exposed to credit risk from its customers. While the operations serve markets in Western Canada and the United States, the Company has a large number of customers, which minimizes the concentration of credit risk. As at December 31, 2010, the Company's credit risk exposure consists mainly of the carrying amounts of accounts receivable.

As at December 31, 2010, $0.9 million of the outstanding receivables were greater than 90 days outstanding. Approximately $0.3 million of this relates to the Manufacturing segment and the remaining $0.6 million relates to the Aviation segment. Management at each of the Company's subsidiaries monitor accounts receivables overdue amounts on a daily basis and respond accordingly. The Company's subsidiaries maintain an adequate allowance for doubtful accounts and review the allowance on a monthly basis.

## Liquidity Risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they become due or can do so only at excessive cost. The Company's growth is financed through a combination of the cash flows from operations, borrowing under existing credit facilities, the issuance of either or a combination of debentures and equity. Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents and the availability of funding through adequate amount of committed credit facilities. One of management's primary goals is to maintain an optimal level of liquidity through the active management of the assets and liabilities as well as cash flows. Due to the nature of the business, the Company aims to maintain flexibility in funding by keeping committed credit facilities available (Note 9).

The Company's financial liabilities and related capital amounts have contractual maturities which are summarized below:

| | Payments due for the years ending December 31 | | | | | |
|---|---|---|---|---|---|---|
| | Total | 2011 | 2012 | 2013 | 2014 | Thereafter |
| Accounts payable and accrued expenses | $ 35,210 | $ 35,210 | $ – | $ – | $ – | $ – |
| Long-term debt | 53,410 | – | – | 53,410 | – | – |
| Convertible debentures | 57,083 | 1,075 | – | – | 26,008 | 30,000 |
| Total | $ 145,703 | $ 36,285 | $ – | $ 53,410 | $ 26,008 | $ 30,000 |

The Company is subject to risk that it will encounter difficulty in renegotiating a renewal of its existing senior debt facility (Note 9) or funds to meet the commitment associated with the debt facility that becomes due in 2013. The Company does not anticipate any significant problem in renegotiating a credit facility to renew or replace the credit facility at the end of its term. The Company has the ability to settle all the issued convertible debentures with Shares of the Company or cash, at the Company's option.

### Fair Value

For the Company's current financial assets and liabilities, which are subject to normal trade terms, the historical cost carrying values approximate the fair values due to the immediate or short-term maturities of these financial instruments. For the Company's credit facility, the historical cost carrying values approximate the fair values, since the interest rate is derived from floating rates. For the Company's aircraft financing debt that matured in 2010, the interest rates were fixed and considered to approximate fair value given the conditions of the financing for an aircraft.

The fair value for the Company's debentures will change based on the movement in bond rates. The fair value of the cash flows associated with the debentures outstanding is $55,866 at December 31, 2010 (2009 – $54,319).

## 24. CONTINGENCIES

During the ordinary course of business the Company and its subsidiaries may be made party to certain claims and become contingently liable for various matters. Management believes that adequate provisions have been recorded in the accounts where required.

### Contingent Purchase Price

As part of the acquisition of a portion of the Water Blast business in 2007, the purchase price contained a contingent payment that was payable to the vendor upon certain financial thresholds being met by the acquired company subsequent to the acquisition date of September 14, 2007. The financial thresholds are assessed on the individual fiscal periods ending in 2011 and the maximum contingent payment was $300. The purchase price allocation for the acquisition resulted in excess of the fair value of the acquired net assets over the cost ("negative goodwill"). In accordance with the guidance of CICA Handbook Section 1581 – Business Combinations, in this situation when negative goodwill is determined, an amount equal to the lesser of the maximum amount of contingent consideration and the negative goodwill should be recognized as if it were a liability. As a result, a contingent liability of $167 was recorded on the balance sheet.

During 2009, the contingent payment was settled with the vendor that resulted in a cash payment of $60 to the vendor and in accordance with Section 1581 certain long-term assets acquired were written down by $87 on the balance sheet for the difference between the settled payment and the contingent liability recorded. The remaining difference of $20 is recorded as a recovery of expenses in general and administrative expenses during 2009.

## 25. RELATED PARTY TRANSACTIONS

The Company has a marketing agreement with Tribal Councils Investment Group ("TCIG"), whose president is a director of the board of the Company. The agreement is in the normal course of operations, at market terms and conditions, except that the compensation is payable to TCIG in either Shares of the Company or cash, and is recognized in the consolidated financial statements at the exchange amounts. The compensation to TCIG is conditional on the annual increase in sales at Perimeter. The Company incurred commissions of $148 in 2010 (2009 – $404). The amount payable to TCIG at December 31, 2010 is $221 (2009 – $411).

Certain Water Blast retail and manufacturing locations in Alberta are leased from the current president of Water Blast who was the vendor that sold Water Blast to the Company. These leases are considered to be at market terms and recognized in the consolidated financial statements at the exchange amounts. These leases are scheduled to end in the beginning of 2012. The total costs incurred in 2010 under these leases are $704 (2009 – $723) and recorded under general and administrative expenses, and, at December 31, 2010, there is no related party balance recorded on the balance sheet (2009 – nil). The total future minimum lease payments under these leases are described further in Note 22.

With the acquisition of Stainless effective January 2, 2008, certain buildings are leased by Stainless from the vendors, one of whom is the current president of Stainless. The lease is considered to be at market terms and is recognized in these consolidated financial statements at the exchange amount. The lease term expires in 2013. The total costs incurred during 2010 are approximately $371 and recorded under general and administrative expenses (2009 – $411). As at December 31, 2010, there is no related party balance recorded on the balance sheet (2009 – nil). The future minimum lease payments under the lease are approximately US $360 annually.

The Company's legal counsel is Aikins, MacAulay & Thorvaldson LLP ("Aikins") in Winnipeg, Manitoba, whose Managing Partner is a director on the board of the Company. The transactions are at market terms and conditions. These transactions are in the normal course of operations associated with legal professional services and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Depending on the services provided, certain costs are expensed in the period incurred, some costs that are considered transaction costs associated with financial liabilities are recognized as interest expense over the life of the related financial instrument, while other costs associated with the raising of equity are recorded as issuance costs against the related equity item. The total costs of services provided during 2010 are $1,193 (2009 – $2,314). As at December 31, 2010, a payable balance of $552 is recorded on the balance sheet (2009 – $8).

The Company has had business relationships with Wellington West Capital Inc. ("Wellington West") in Winnipeg, Manitoba. The chairman of the board of directors for the Company is also a member of the board of Wellington West. The transactions are at market terms and conditions. These transactions are in the normal course of operations associated with the raising of funds for the Company through private and public offerings, and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Depending on the services provided, certain costs are expensed in the period incurred, some costs that are considered transaction costs associated with financial liabilities are recognized as interest expense over the life of the related financial instrument, while other costs associated with the raising of equity are recorded as issuance costs against the related equity item. The total costs of services provided during 2010 are $126 (2009 – $769). The amount payable to Wellington West recorded as at December 31, 2010 is nil (2009 – nil).

## 26. OTHER COMPREHENSIVE INCOME (LOSS)

During the 2010 year the Company had other comprehensive losses of $688 (net of $69 tax) that relates to foreign currency translation adjustments of the operations of Stainless from US dollars to the Canadian dollar reporting currency (2009 – losses of $2,787, net of $244 tax). The resulting translation adjustments are included in other comprehensive income and are only included in the determination of net income when a reduction in the investment in these foreign operations is realized.

## 27. SUBSEQUENT EVENTS

### Bearskin Acquisition

During 2010 the Company announced that it had signed a letter of intent to acquire the airline operations and assets of Bearskin Airlines, a privately-owned commuter airline providing passenger service in Ontario and Manitoba. The Company completed the acquisition on January 1, 2011. The acquisition price of $32.5 million was funded through a combination of $27.6 million of debt financing from the Company's credit facility and the issuance of the Company's common shares worth $4.9 million to the vendors of Bearskin (314,047 shares).

The results of operations will be included in the Company's Consolidated Statement of Operations from the date of acquisition and as a result the 2010 financial statements do not include any results of Bearskin. As at December 31, 2010, the Company had restricted cash of $27,625 associated with the deposit in trust for the Bearskin acquisition that closed at the beginning of 2011.

### Series I Convertible Debenture Offering

On January 11, 2011, the Company announced the closing of a bought deal offering of five-year 5.75% Series I convertible senior secured debentures with a $26.00 conversion price. A total $35,000 principal amount of debentures were issued and will mature in 2016. The Company used the net proceeds of the offering to reduce the amount outstanding of the Company's credit facility by making a $32,000 payment and the remainder was used for general corporate purposes.

### Acquisition Target – Westower Communications

Subsequent to 2010, the Company announced on March 9, 2011 that it signed a letter of intent to acquire the shares of Westower Communications ("Westower"), which is a manufacturing and service entity that operates throughout Canada and the United States in the wireless tower industry, mainly in the design, erection, reinforcing, maintenance and servicing of towers. The acquisition price is $79 million and will be funded through a combination of the use of available proceeds in the Company's senior credit facility and Shares of the Company to the Westower vendors totaling 15% of the purchase price. Pending final due diligence and satisfaction of typical conditions, the transaction is expected to close at the beginning of the second quarter of 2011.

### Credit Facility Amendments

Also on March 9, 2011 the Company announced that its senior credit facility will be amended to increase the credit available under the facility to $235 million and the term will be extended another year at the same time (May 2014 maturity). The total facility will consist of a $200 million portion and a US $35 million portion.

# Board of Directors & Senior Management

## Board of Directors

**Hon. Gary Filmon, P.C., O.C., O.M.**
Chairman

**Duncan D. Jessiman, Q.C.**
Executive Vice-Chairman

**Allan McLeod**

**Brad Bennett**

**Donald Streuber**

**Edward Warkentin**

**Gary Buckley**

**Michael Pyle**

**William Wehrle**

## Senior Management

**Michael Pyle**
President & Chief Executive Officer

**Adam Terwin**
Chief Financial Officer

**Duncan D. Jessiman, Q.C.**
Executive Vice-Chairman

**Darwin Sparrow**
Vice-President & Chief Operating Officer, Manufacturing

**Michael Rodyniuk**
Vice-President & Chief Operating Officer, Aviation

**Gary Bell**
Vice-President, Corporate Development

# Corporate information

## Officers

**Michael Pyle**
President & Chief Executive Officer

**Adam Terwin**
Chief Financial Officer

**Darwin Sparrow**
Vice-President & Chief Operating Officer, Manufacturing

**Michael Rodyniuk**
Vice-President & Chief Operating Officer, Aviation

**Gary Bell**
Vice-President, Corporate Development

**Dianne Spencer**
Corporate Secretary

**Legal Counsel**
Aikins, MacAulay & Thorvaldson LLP
Winnipeg, Manitoba

## Auditors

Deloitte & Touche LLP
Winnipeg, Manitoba

## Bankers

TD Canada Trust
Roynat Inc.
CIBC
Alberta Treasury Board

## Transfer Agent

CIBC Mellon Trust Company
Calgary, Alberta

## Stock Exchange Listing

Exchange Income Corporation
EIF.T TSX

## Annual General & Special Meeting

Calm Air Hangar Facility
50 Morberg Way
Winnipeg, Manitoba R3H 0A4
Friday, May 13, 2011
at 10:30 a.m. (CST)

## Corporate Office

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## Website Listings

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Keewatin Air: www.keewatinair.ca
Perimeter Aviation: www.perimeter.ca
Jasper Tank Manufacturing: www.jaspertank.com
Overlanders Manufacturing: www.overlanders.com
Stainless Fabrication: www.stainlessfab.com
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