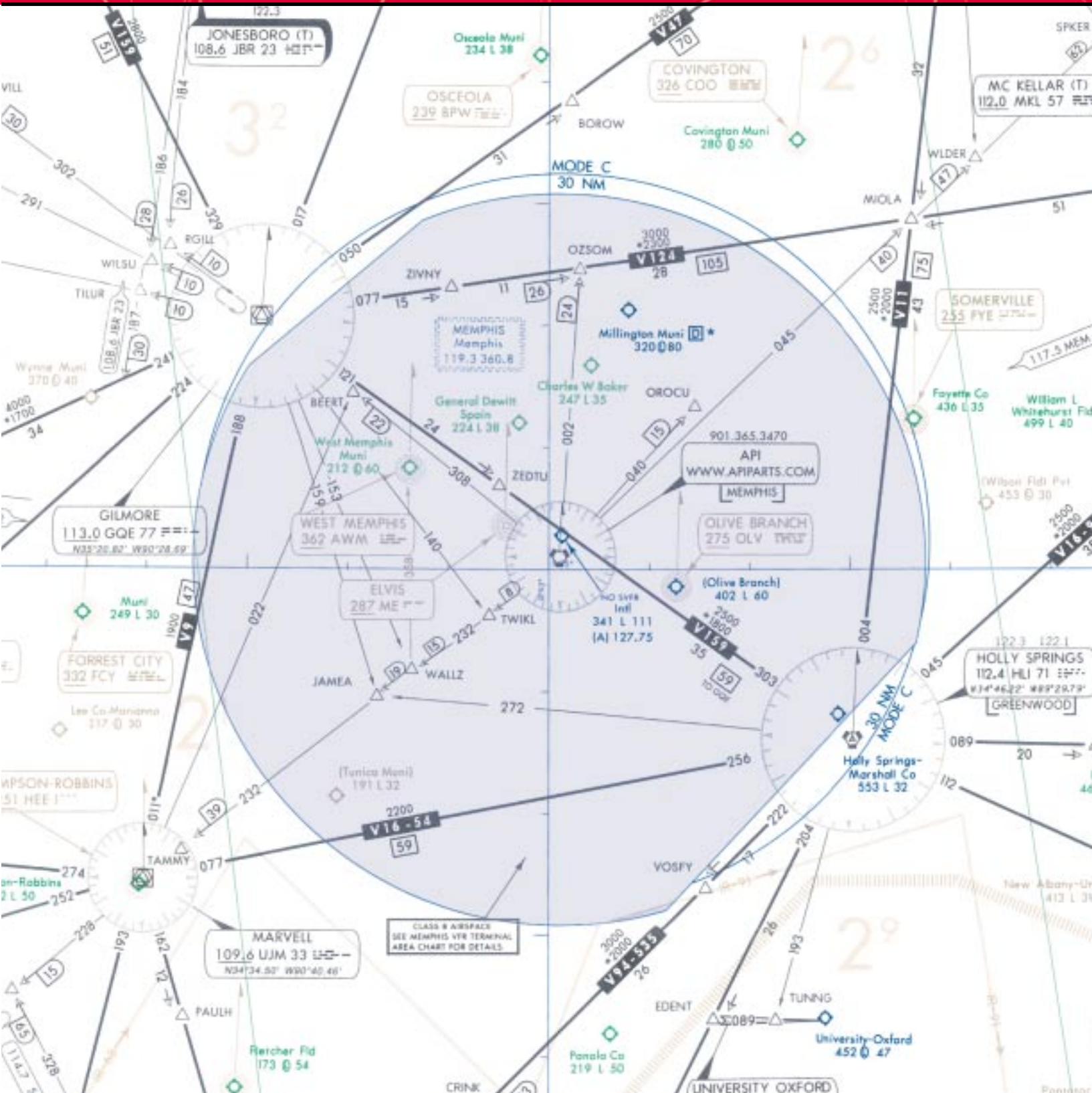


# FIRST AVIATION SERVICES INC. ANNUAL REPORT 2003





## CONTENTS

- Letter To Our Shareholders.....2*
- Review of Operations .....4*
- Consolidated Financial Statements .....8*
- Notes to Consolidated Financial Statements .....14*
- Shareholder Information .....23*

First Aviation Services Inc. (FAvS), together with its principal operating subsidiary, Aerospace Products International, Inc. (API), is one of the premier suppliers of aircraft parts and components to the aviation industry worldwide, and is a provider of supply chain management services, including third party logistics and inventory management services, to the aerospace industry. API (with locations in the U.S., Canada, and Asia, plus global partners throughout the world) distributes the products of over 150 parts and components manufacturers and suppliers. In addition, API performs brake and starter/generator overhaul services, and is a Federal Aviation Administration authorized hose assembly facility. Customers of FAvS include passenger and cargo airlines, fleet and corporate aircraft operators, fixed base operators, helicopter and recreational operators, certified repair facilities, flight training schools, governments and military services.

### MISSION STATEMENT

*To be a global leader in all the markets that we serve. We are driven by our unfailing commitment to quality and value. In meeting the challenge of emerging as the premier aviation services provider, we will embrace change by constantly breaking new ground, fostering new ideas and developing new technologies.*



**F**ew years could have been more challenging to our industry than this past one. Airlines, already facing high debt levels and reduced traffic, did not have the balance sheets or organizational flexibility to withstand the aftershocks of September 11th. Nearly every segment, including commercial airlines, cargo carriers, and general aviation, faced a near meltdown. Only a few well-managed and highly efficient airlines proved profitable. To survive, the rest of the industry must rethink their entire value proposition.

With crumbling debt ratings, bankruptcies of major carriers, burdensome restrictions on general aviation, and the prospects of war, more was asked from the API team than ever before. They rose to the occasion. We are very fortunate to have such a great team.

Sales inevitably declined as we tightened credit. But that does not tell the whole story. Market share increased, the logistics side of the business showed good growth, margins improved, and nearly \$3.4 million of cash was provided by operating activities. Our healthy balance sheet was maintained. We continued to invest in technology, taking the long-term view.

It would have been tempting to grow the top line this year and we could have, but we believed that we would not see a quick recovery in the industry. In retrospect, the Company's decision to tighten credit was correct even though it cost us sales. In light of the current economic environment and in our continuing effort to be conservative, we have taken additional bad debt reserves.

During the year, we took non-cash charges of \$5.5 million, relating to bad debts, goodwill and taxes, as described in more detail in the financial section. API was profitable before these charges.

For the first time since going public, the board of directors approved the issuance of a \$1.00 per share dividend in January. It was the board's opinion that a company generating strong cash flow that has adequate funds for operations and potential acquisitions should let the investors decide how to invest their capital. At year-end we still had more than \$26 million in cash and \$14.5 million of debt. Our share price is depressed but we believe our company is being incorrectly

grouped with other aviation businesses that do not have our strong balance sheet and powerful track record. If we perform as a company and create value, the stock price will, over time, reflect reality.

Despite the environment, we remain optimistic about the future of the industry, in general, and API, specifically. While it is our nature to be optimistic, there are reasons to believe that some positive results will come of the financial turmoil. More airlines and original equipment manufacturers than ever before are looking at fundamentally changing their supply chain by reengineering their businesses. They now realize that they must be the low-cost producer, deliver a quality product, and compete on their ability to

respond to the market. This is a tremendous opportunity for API. Our logistics contracts represent innovative solutions to the industry's high costs and will play an increasingly important part in the supply chain for our customers.

API has been the technological leader in our industry over the last decade. We brought single point distribution to an industry hampered by legacy systems and brick and mortar built over a hundred years. In this time we went from a minor player to number two in our market segment. Our vision is to remain the technological leader in the future for supply chain management. The market is seeing API not only as the most efficient distributor but also as a seller of technology and solutions. FAvS and API will continue to embrace change.

We would like to especially thank our team members and board of directors during this tumultuous year. They have been supportive and determined in maintaining our leadership position. We are very grateful.

Sincerely,



Aaron Hollander



Michael Culver

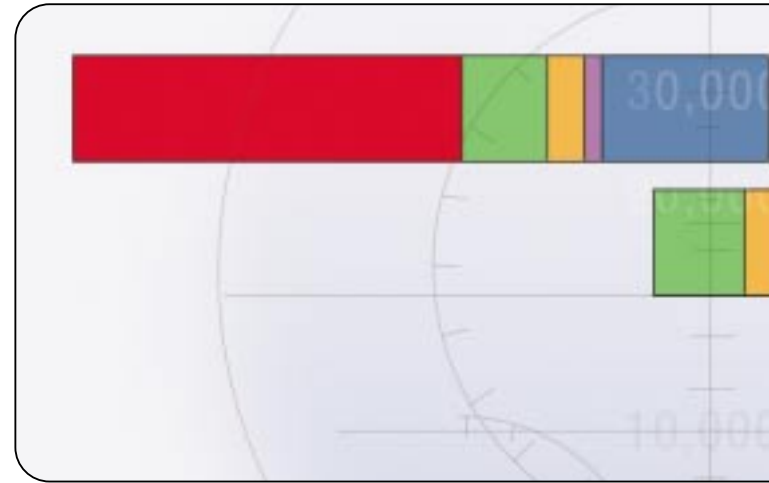
**In July 2002, the Company entered into a long-term contract to provide supply chain management services to Gulfstream Aerospace Corporation**



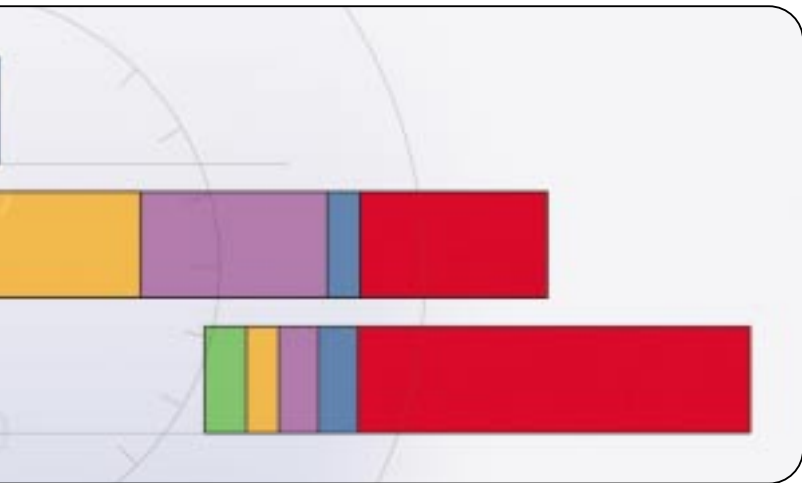
**A**

*API, First Aviation's principal subsidiary,* based in Memphis, Tennessee, offers supply chain management solutions to the aerospace industry.

While the company's roots are in parts distribution, API is in the service business, not the parts business. The company offers solutions for improving the efficiency of the administration of the aviation supply chain. API sells business processes and technology that allow its customers to increase operating margins while better serving their customers. API's services also provide its ultimate end-user with a superior ownership experience. This gives API's customers the opportunity to build long-term loyalty with their customers, and thus create value.



API offers parts and components supply and logistics services that use, fundamentally, the same technology and systems platforms. API's parts and components supply services business model is based on single point warehousing and distribution. This offers the aerospace after-market the most effective parts and components supply service in the industry. Availability, documentation/traceability, service and price drive customers' purchase decisions in the parts distribution business. API's single point distribution model allows the company to provide its customers with superior parts availability and documentation, and a service level that is difficult to match with the distributed branch system used by API's competitors. In a recent independent survey, API ranked very high against its competitors with respect to these criteria. In addition, the single point concept creates excellent economies of scale in systems, asset management and human resources, giving API the lowest cost structure and the highest agility in the industry.



**API's supply chain management services reduce duplicative costs and improve customer service.**



API provides its customers with 97% of their parts requirements on a worldwide, next-day basis. API's customers can place orders as late as midnight EST and receive parts on the shop floor by 8 AM the next morning. As a result, API's customers, such as aircraft repair stations, need not hold inventory nor incur the risks associated with inventory management. This illustrates the ability of API to create value for its customers. API measures its performance by the breadth of its service and how quickly and reliably it can meet its customers' needs.

API's logistics services offer all activities that relate to supply chain management. While API has been developing its supply chain management services for several years, the increased focus of a dedicated logistics services group has resulted in API being awarded: Federal Express contracts for oils, lubricants and shelf-life products for the second time; the exclusive third-party logistics contract with Superior Air Parts, wherein API is responsible for order intake, pick-pack-and-ship, reverse logistics, tier one technical support and invoicing; and an integrated supply chain



**API is one of the largest distributors of parts to the general aviation market.**

management contract from General Dynamics' Gulfstream Aerospace Corporation for its aviation services after-market support business. While each contract is unique, API offers the aerospace industry a portfolio of services and programs that leverage API's technology, its warehouse infrastructure, and its single point logistics and distribution model. Supply chain services offered by API include shelf-life management, systems integration, reverse logistics, call-center management, specialized product training, inventory management, fulfillment, credit authorization, payment/settlement, quality assurance, MR&O management, e-commerce, technical support, kitting, report and analysis generation, and direct-line feed. In the case of Gulfstream,

API's managers are in-sourced to Gulfstream's after-market support business organization.

API is totally focused on taking process costs and working capital out of the aviation supply chain. Airlines spend an estimated \$ .40 to \$ .50 of every maintenance dollar on administrative and overhead costs – not parts, nor direct labor. U.S. airlines spend approximately \$30 to \$40 billion on maintenance; 50 percent of this number represents an enormous opportunity to increase efficiency and profitability in the airline business.

There is some confusion about what logistics means, both in the investment community and in the aerospace market. At API, logistics means providing long-term, value-added services that offer our customers higher quality and lower costs.

**Supply chain solution:**  
API's "Consumables Direct Ship Program" with FedEx Express covers 250+ line items shipped direct to 162 line stations worldwide.



It is providing our customers with the tools that they need to respond quickly to the marketplace, to forecast accurately, and to increase productivity of direct labor and the efficiency of their administrative back office functions. Some in the market view “pay-to-play” distribution agreements as logistics. We do not. “Pay-to-play” is essentially a long-term, exclusive distribution agreement with an OEM in which the OEM receives a substantial upfront fee for the right to distribute a product exclusively and recover the working capital invested in their inventory. API has decided not to participate in this arena. While “pay-to-play” offers short-term benefits, the Company does not believe that it creates a strong long-term value proposition. First Aviation has decided that “pay-to-play” is not the highest and best use of its capital nor does it optimize the supply chain. API invests in developing proprietary systems that create long-term defensible service offerings rather than tying up dollars in working capital.

Customers choose API because of a combination of suitable and robust technology, human creativity, and a sustainable business model.

API will continue to pursue growth in both traditional parts supply services and supply chain management services. API is examining all logical acquisition candidates in traditional distribution to add volume to its infrastructure. At the same time, API is approaching acquisition targets that would provide the Company with a proprietary market position or technology in the supply chain management market.

API’s success and its profitability are directly linked to increasing its customers’ profitability through the reduction of their costs and their investments in working capital.



**As a result of the industry turmoil, more airlines are looking to outsource non-core tasks, which is an opportunity for the Company.**



INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

*Report of Independent Auditors* ..... 8

*Consolidated Financial Statements:*

*Consolidated Balance Sheets* ..... 9

*Consolidated Statements of Operations*..... 10

*Consolidated Statements of Stockholders' Equity*..... 11

*Consolidated Statements of Cash Flows* ..... 12

*Notes to Consolidated Financial Statements* ..... 14

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders  
First Aviation Services Inc.

We have audited the accompanying consolidated balance sheets of First Aviation Services Inc. as of January 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of First Aviation Services Inc. as of January 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for goodwill effective February 1, 2002.



Stamford, Connecticut  
April 16, 2003

## CONSOLIDATED BALANCE SHEETS *(in thousands, except share amounts)*

	January 31,	
	2003	2002
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 26,013	\$ 31,113
Trade receivables, net	12,978	15,396
Inventories, net	20,617	23,016
Prepaid expenses and other	1,794	1,851
Deferred and refundable income taxes	—	1,212
Total current assets	61,402	72,588
Plant and equipment, net	3,639	4,100
Goodwill, net	—	3,856
	\$ 65,041	\$ 80,544
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 10,324	\$ 11,464
Accrued compensation and related expenses	1,060	1,195
Other accrued liabilities	1,009	1,553
Income taxes payable	1,009	1,293
Current obligations under capital leases	4	180
Total current liabilities	13,406	15,685
Long-term debt	14,500	14,800
Minority interest in subsidiary	1,041	1,041
Total liabilities	28,947	31,526
Stockholders' equity:		
Common stock, \$0.01 par value, 25,000,000 shares authorized, 9,135,699 shares issued, respectively	91	91
Additional paid-in capital	38,445	38,516
Retained earnings	7,543	20,728
Accumulated other comprehensive loss	(96)	(193)
	45,983	59,142
Less: Treasury stock, at cost, 1,884,989 and 1,921,946 shares, respectively	(9,889)	(10,124)
Total stockholders' equity	36,094	49,018
Total liabilities and stockholders' equity	\$ 65,041	\$ 80,544

*see accompanying notes*

**CONSOLIDATED STATEMENTS OF OPERATIONS** *(in thousands, except share amounts)*

	<b>Year ended January 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
Net sales	<b>\$ 101,737</b>	\$ 105,696	\$ 97,550
Cost of sales	<u>83,264</u>	<u>86,680</u>	<u>79,007</u>
Gross profit	<b>18,473</b>	19,016	18,543
Selling, general and administrative expenses	<b>17,656</b>	16,896	17,408
Corporate expenses	<b>2,394</b>	2,628	2,934
Litigation (income) expense	<u>–</u>	<u>(735)</u>	<u>501</u>
Income (loss) from operations	<b>(1,577)</b>	227	(2,300)
Interest income	<b>273</b>	592	1,955
Interest and other expenses	<b>(67)</b>	(291)	(538)
Minority interest in subsidiary	<u>(42)</u>	<u>(42)</u>	<u>(42)</u>
Income (loss) before income taxes	<b>(1,413)</b>	486	(925)
(Provision) benefit for income taxes	<u>(1,786)</u>	<u>(194)</u>	<u>349</u>
Income (loss) from continuing operations before cumulative effect of accounting change	<b>(3,199)</b>	292	(576)
Loss from discontinued operation	–	–	(1,847)
Gain from dispositions of subsidiaries	–	960	593
Cumulative effect of accounting change	<u>(2,735)</u>	<u>–</u>	<u>–</u>
Net income (loss)	<b><u>\$ (5,934)</u></b>	<b><u>\$ 1,252</u></b>	<b><u>\$ (1,830)</u></b>
<i>Basic net income (loss) per share, and net income (loss) per share – assuming dilution:</i>			
Income (loss) from continuing operations before cumulative effect of accounting change	<b>\$ (0.44)</b>	\$ 0.04	\$ (0.08)
Income (loss) from discontinued operation	–	–	(0.24)
Gain from dispositions of subsidiaries	–	0.13	0.08
Cumulative effect of accounting change	<u>(0.38)</u>	<u>–</u>	<u>–</u>
Basic net income (loss) per share, and net income (loss) per share – assuming dilution	<b><u>\$ (0.82)</u></b>	<b><u>\$ 0.17</u></b>	<b><u>\$ (0.24)</u></b>
Weighted average shares outstanding – basic	<b><u>7,224,532</u></b>	<b><u>7,197,941</u></b>	<b><u>7,720,520</u></b>
Weighted average shares outstanding – assuming dilution	<b><u>7,224,532</u></b>	<b><u>7,208,725</u></b>	<b><u>7,720,520</u></b>

*see accompanying notes*

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY *(in thousands, except share amounts)*

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss		Treasury Stock	Total
	Number of Shares	Amount			Sub-Total			
Balances at January 31, 2000	8,133,997	\$ 91	\$ 38,615	\$ 21,306	\$ -	\$ 60,012	\$ (5,869)	\$ 54,143
Shares issued to directors	1,702	-	10	-	-	10	-	10
Common shares repurchased	(1,023,398)	-	-	-	-	-	(4,834)	(4,834)
Proceeds from issuance of common stock from treasury, and shares issued under qualified plans and to directors from treasury	72,403	-	-	-	-	-	343	343
Net loss	-	-	-	(1,830)	-	(1,830)	-	(1,830)
Balances at January 31, 2001	7,184,704	91	38,625	19,476	-	58,192	(10,360)	47,832
Shares issued under qualified plans and to directors	30,149	-	(109)	-	-	(109)	241	132
Common shares repurchased	(1,100)	-	-	-	-	-	(5)	(5)
Other comprehensive loss	-	-	-	-	(193)	(193)	-	(193)
Net income	-	-	-	1,252	-	1,252	-	1,252
Balances at January 31, 2002	7,213,753	91	38,516	20,728	(193)	59,142	(10,124)	49,018
<b>Exercise of stock options to purchase common shares</b>	<b>10,800</b>	-	-	-	-	-	<b>63</b>	<b>63</b>
<b>Shares issued under qualified plans and to directors</b>	<b>26,157</b>	-	<b>(71)</b>	-	-	<b>(71)</b>	<b>172</b>	<b>101</b>
<b>Other comprehensive income</b>	-	-	-	-	<b>97</b>	<b>97</b>	-	<b>97</b>
<b>Dividends paid</b>	-	-	-	<b>(7,251)</b>	-	<b>(7,251)</b>	-	<b>(7,251)</b>
<b>Net loss</b>	-	-	-	<b>(5,934)</b>	-	<b>(5,934)</b>	-	<b>(5,934)</b>
Balances at January 31, 2003	<u>7,250,710</u>	<u>\$ 91</u>	<u>\$ 38,445</u>	<u>\$ 7,543</u>	<u>\$ (96)</u>	<u>\$ 45,983</u>	<u>\$ (9,889)</u>	<u>\$ 36,094</u>

see accompanying notes

**CONSOLIDATED STATEMENTS OF CASH FLOWS** *(in thousands)*

	<b>Year ended January 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Cash flows from operating activities</b>			
Net income (loss)	\$ (5,934)	\$ 1,252	\$ (1,830)
Adjustments to reconcile net income (loss) to net cash from operating activities – non cash expense (income):			
Depreciation and amortization	1,372	1,399	1,251
Deferred income taxes	1,786	–	(148)
Compensation paid through issuance of stock	104	112	72
Loss from discontinued operation	–	–	1,117
Gain from dispositions of subsidiaries	–	(960)	(593)
Cumulative effect of accounting change	2,735	–	–
(Increase) decrease in working capital assets:			
Trade receivables	2,418	467	(2,050)
Inventories	2,399	1,708	(7,661)
Prepaid expenses and other assets	421	(73)	(1,662)
Increase (decrease) in working capital liabilities:			
Accounts payable	(1,140)	(2,032)	5,232
Other accrued liabilities	(685)	–	(7,812)
Income taxes payable	(87)	–	–
Net cash provided by (used in) operating activities	<u>3,389</u>	<u>1,873</u>	<u>(14,084)</u>
<b>Cash flows from investing activities</b>			
Purchases of plant and equipment and other assets – continuing operations	(925)	(683)	(1,529)
Purchase of assets from Superior, including acquisition costs	–	(5,028)	–
Purchases of plant and equipment – discontinued operations	–	–	(1,494)
Net cash used in investing activities	<u>(925)</u>	<u>(5,711)</u>	<u>(3,023)</u>

*see accompanying notes*

## CONSOLIDATED STATEMENTS OF CASH FLOWS *continued (in thousands)*

	<b>Year ended January 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Cash flows from financing activities</b>			
Net borrowings (repayments) on long-term debt and capital lease obligations	\$ (476)	\$ 3,076	\$ 3,411
Repurchases of common stock for treasury	-	(5)	(4,834)
Dividends paid	(7,251)	-	-
Other	60	25	281
Net cash provided by (used in) financing activities	<u>(7,667)</u>	<u>3,096</u>	<u>(1,142)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>103</u>	<u>-</u>	<u>-</u>
Net change in cash and cash equivalents	\$ (5,100)	\$ (742)	\$ (18,249)
Cash and cash equivalents at the beginning of the year	<u>31,113</u>	<u>31,855</u>	<u>50,104</u>
Cash and cash equivalents at the end of the year	<u>\$ 26,013</u>	<u>\$ 31,113</u>	<u>\$ 31,855</u>
<b>Supplemental cash flow disclosures</b>			
Cash paid for:			
Interest	<u>\$ 54</u>	<u>\$ 130</u>	<u>\$ 455</u>
Income taxes (refunded) paid, net	<u>\$ (322)</u>	<u>\$ (748)</u>	<u>\$ 4,196</u>
Acquisition of equipment through incurrence of capital lease obligation	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 315</u>

*see accompanying notes*

(in thousands, except share amounts)

## 1. Business and Basis of Presentation

First Aviation Services Inc. ("First Aviation"), through its wholly-owned subsidiaries, Aircraft Products International, Ltd., API Asia Pacific Inc., and its majority-owned subsidiary, Aerospace Products International, Inc. ("API"), (collectively the "Company"), is one of the premier suppliers of products and services to the aerospace industry worldwide, including the provisioning of aircraft parts and components, and supply chain management services. The Company also performs overhaul and repair services for brakes and starter/generators, and builds custom hose assemblies. The Company has its headquarters in Westport, Connecticut.

The accompanying consolidated financial statements include the accounts of First Aviation and its subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation.

First Aviation was formed in March 1995 to acquire the capital stock of National Airmotive Corporation ("NAC"). On March 5, 1997, the Company completed an initial public offering of its common stock. A portion of the proceeds was used to acquire API's business from AMR Combs, Inc. ("AMR Combs").

As described in Note 10, on August 10, 2001 the Company acquired the distribution business of Superior Air Parts, Inc. ("Superior"). As described in Note 11, in prior years the Company sold NAC, and disposed of AeroV Inc. ("AeroV"), its former e-commerce subsidiary. Accordingly, NAC and AeroV have been accounted for as discontinued operations and their results of operations, cash flows and the net gain or loss on operations and on disposition have been condensed and reported separately in the accompanying consolidated financial statements. As described in Note 3, during the year the Company changed its accounting for goodwill and, accordingly, reported the net cumulative effect of the accounting change separately in the consolidated statements of operations.

## 2. Summary of Significant Accounting Policies

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates, and the differences may be significant.

### Net Sales, Cost of Sales, and Trade Receivables

The Company's net sales consist of sales of products and services, including aircraft parts and components, component overhaul and repair services, and supply chain management services. Net sales are recorded when parts and components are shipped and title transfers to the customer, when overhaul and repair services are completed and the item is shipped back to the customer, or when supply chain management

services have been provided to the customer. Shipping and handling fees billed to customers are included in net sales. The terms and nature of supply chain management services provided are stipulated in a long-term contract between the Company and the customer. The Company provides its facilities, personnel and systems to provide cost effective services to the customer. In providing services where the Company distributes inventory on behalf of its customer, the Company may use its own inventory or hold its customers' inventory without taking ownership of such inventory. In cases where the Company does not take ownership of its customers' inventory, net sales generally are recognized as a fee based on the sales value of the product shipped through the Company's facilities, and not the sales value of the product itself.

Cost of sales consists of costs of inventory sold, costs to overhaul and repair parts and components, and direct costs of providing services.

Sales to unaffiliated foreign customers were approximately 18%, 17% and 13% of net sales for the years ended January 31, 2003, 2002 and 2001, respectively. The majority of these customers were located in Canada, Southeast Asia, Latin America, and Europe.

The Company provides credit in the form of trade accounts receivable to its customers. The Company generally does not require collateral to support domestic customer receivables. Receivables arising from export activities may be supported by foreign credit insurance. The Company performs ongoing credit evaluations of its customers and maintains allowances that management believes are adequate for potential credit losses. During the three months ended January 31, 2003, due to continued deteriorating economic conditions, especially in the aerospace industry, the Company recorded a charge of \$804 to increase its allowance for doubtful accounts. The allowance for doubtful accounts was \$1,656 and \$707, at January 31, 2003 and 2002, respectively.

### Shipping and Handling Revenues and Costs

Fees billed to customers associated with shipping and handling activities are classified as revenue, and costs associated with shipping and handling are classified as part of cost of sales. Previously, shipping and handling costs were included in selling, general and administrative expenses. These costs have been reclassified to cost of sales for all periods presented.

### Stock-Based Compensation and Stock Options Issued to Employees

In lieu of cash, the Company's directors elect to receive their compensation in the form of the Company's stock. The value of stock issued is equivalent to the compensation expense, and the number of shares issued is based upon the fair market value per share at the date issued.

The Company generally grants stock options to its employees for a fixed number of shares with an exercise price equal to the fair market value of the stock on the date of grant. As permitted under Statement of Financial Accounting Standard No. ("FAS") 123, "Accounting for Stock-Based Compensation", the Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations in accounting for stock awards to employees. No

compensation expense was recognized during the years ending January 31, 2003, 2002 and 2001 since all grants were issued at the fair market value of the Company's common stock at the date of grant.

The Company is required to disclose the fair value, as defined, of options granted to employees and the related compensation expense. The fair value of the stock options granted was estimated at the date of grant using a Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. In management's opinion, because the Company's employee stock options are not publicly traded, and have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The fair value of each option issued was estimated at the date of grant using the following assumptions for the years ended January 31:

	2003	2002	2001
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	2.5%	4.0%	5.0%
Expected volatility	37.4%	41.9%	49.3%
Expected life of option	5.0 years	4.0 years	4.0 years
Weighted-average fair value of options granted during the year	\$ 1.77	\$ 1.64	\$ 2.24

Using the above noted assumptions and the weighted-average fair value of each option granted, the net income (loss) and earnings (loss) per share that would have been recorded was approximately \$(6,229), \$1,130 and \$(2,072), or \$(0.86), \$0.16 and \$(0.27) per share, for the years ended January 31, 2003, 2002 and 2001, respectively.

#### **Cash and Cash Equivalents**

Cash and cash equivalents at any time may consist of a combination of demand deposits, money market or short-term, high-grade bond funds, and short-term certificates of deposit.

#### **Inventories**

Inventories generally consist of aircraft parts and components and are stated at the lower of cost or market, using the first-in, first-out method. Provisions are made in each period for the estimated effect of obsolete and slow moving inventories. Actual obsolete and slow moving inventories may differ significantly from such estimates, and such differences could be material to the financial statements. The allowance for obsolete and slow moving inventory was \$997 and \$885, at January 31, 2003 and 2002, respectively.

#### **Fair Value of Financial Instruments**

The carrying values of current assets and liabilities approximate fair market value due to the short-term maturities of these assets and liabilities.

#### **Plant and Equipment**

Plant and equipment are stated at cost, less an allowance for depreciation. Additions and improvements that materially increase the productive capacity or extend the useful life of an asset are added to the cost of the asset. Expenditures for normal maintenance and repairs are charged to expense as incurred.

Depreciation of plant and equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 15 years. Leasehold improvements generally are amortized over the shorter of the estimated life of the improvement or the term of the related lease.

#### **Goodwill**

In prior years, goodwill consisted of the excess of the purchase price of API and Superior over the fair value of the net assets acquired. As described in Note 3, all goodwill was written off during the three months ended April 30, 2002 upon the required adoption of an accounting change. Amortization expense was \$65 and for the years ended January 31, 2002 and 2001, respectively. Accumulated amortization was \$322 at January 31, 2002.

#### **Long-Lived Assets**

During the year ended January 31, 2003, the Company adopted FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Under FAS 144, an impairment loss must be recognized when the carrying amount of a long-lived asset exceeds its fair value. In the event that the carrying amounts of long-lived assets may be impaired, an assessment of recoverability must be performed. The assessment process consists of comparing the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if a write-down is required. If this review process indicates that the asset will not be recoverable, the carrying value of the asset must be reduced to its estimated realizable value. The adoption of FAS 144 had no effect on the consolidated financial position of the Company. No asset impairments were recorded during the years ended January 31, 2003, 2002 and 2001.

#### **Principal Suppliers**

API has five suppliers of parts and components from which approximately 49%, 53% and 49% of its total purchases were made during the years ended January 31, 2003, 2002 and 2001, respectively. Accounts payable to these vendors totaled \$2,531 and \$3,956 at January 31, 2003 and 2002, respectively. An inability to maintain timely access to parts and components from these vendors on commercially reasonable terms would have a material adverse effect on the Company's consolidated business, financial condition and results of operations.

**Income Taxes**

The Company uses the liability method to account for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company records valuation allowances against deferred tax assets as deemed necessary. As described in Note 7, during the three months ended January 31, 2003 the Company recorded a charge of \$1,993 to establish a valuation allowance against its deferred tax assets.

**Accumulated Other Comprehensive Loss**

The accumulated other comprehensive loss rose from the translation of accounts into U.S. dollars where the functional currency is the Canadian dollar. The decrease during the year ended January 31, 2003 was due to an increase in the value of the Canadian dollar relative to the US dollar, and less foreign exposure. Comprehensive income (loss) was (\$5,837) and \$1,059 for the years ended January 31, 2003 and 2002, respectively.

**Reclassifications**

Certain amounts in the accompanying consolidated financial statements have been reclassified to conform to the current year's presentation.

**3. Accounting Change**

During the first quarter ended April 30, 2002, the Company adopted FAS 142, "Goodwill and Other Intangible Assets". Pursuant to FAS 142, goodwill is not amortized but is tested periodically for impairment using discounted cash flows and other fair value methodologies. Upon adoption of FAS 142, the Company was required to perform transitional impairment tests relating to its goodwill and other intangibles existing as of February 1, 2002, the date of adoption. As a result, upon adoption of FAS 142, the Company took a one-time, non-cash charge of \$2,735, net of applicable income tax benefit of \$922, or \$0.38 per share, to write-off the carrying value of its goodwill. No charge was required under previous generally accepted accounting principles, which were based upon undiscounted cash flows.

The adoption of FAS 142 represented a change in accounting principle, and the cumulative effect, net of the applicable income tax benefit, has been shown on a separate line in the consolidated statements of operations. The effective rate of the income tax benefit on the charge was approximately 25%. The difference between the effective income tax rate and the statutory rate was due to differences in book and income tax bases of the assets.

**4. Plant and Equipment**

Plant and equipment consist of the following:

	January 31,	
	2003	2002
Machinery and equipment	\$ 2,025	\$ 1,759
Buildings and leasehold improvements	1,219	1,183
Computer equipment, software, office furniture, fixtures and other office equipment	5,681	5,276
Construction-in-process	184	36
	<u>9,109</u>	<u>8,254</u>
Less: accumulated depreciation	<u>(5,470)</u>	<u>(4,154)</u>
	<u>\$ 3,639</u>	<u>\$ 4,100</u>

Certain equipment has been pledged as collateral under capital leases. Amortization of assets under capital leases is included in depreciation and amortization.

**5. Obligations Under Capital Leases and Long-Term Debt**

	January 31,	
	2003	2002
Current obligations under capital leases	\$ <u>4</u>	\$ <u>180</u>
Long-term debt – revolving line of credit	\$ <u>14,500</u>	\$ <u>14,800</u>

API has a \$20,000 revolving line of credit through a Commercial Revolving Loan and Security Agreement (the "Facility"). Borrowings under this Facility bear interest equal to the LIBOR rate plus 1.5% and are limited to specified percentages of eligible trade receivables and inventories of API. The Facility contains a number of covenants, including restrictions on mergers, consolidations and acquisitions, the incurrence of indebtedness, transactions with affiliates, the creation of liens, and limitations on capital expenditures. Pursuant to the terms and conditions of the Facility, the payment of dividends on API's common stock is prohibited, except with the lender's consent, and API is required to maintain minimum levels of net worth and specified interest expense coverage ratios. Substantially all of API's domestic assets are pledged as collateral under the Facility, and First Aviation guarantees all borrowings under the Facility. Borrowings under the Facility were \$14,500 at January 31, 2003, at an interest rate of approximately 2.9%. An additional total of approximately \$2,951 was available to borrow

under the Facility at January 31, 2003. During the quarter ended July 31, 2002, API extended the maturity date of the Facility to July 1, 2004 from July 1, 2003. The extension of the agreement was on the same terms and conditions as the prior Facility. As a result of the extension, borrowings under the Facility continue to be classified as long-term. Management believes that the carrying amount of the Company's borrowings approximates fair value because the interest rate is variable and resets frequently.

The Company leases certain equipment under leases that have been classified as capital leases. The obligations under the capital leases are recorded at the net present value of the future minimum lease payments. All such obligations are due within one year from the balance sheet date are therefore classified as current. Interest expense on the obligations is recorded as incurred.

## 6. Stockholders' Equity

On January 6, 2003, the Company announced that its Board of Directors, in light of the Company's cash position, had approved a special cash dividend of \$1.00 per share. The dividend was paid on January 30, 2003. The total paid was \$7,251. The Company previously had not declared nor paid any cash dividends or distributions on its common stock since its inception in 1997.

The Company has an Employee Stock Purchase Plan ("ESPP"). Under the ESPP, 250,000 shares of common stock have been reserved for issuance.

With certain limitations, the plan allows for eligible employees to purchase stock through payroll deductions at 85% of the lower of the fair market value of the Company's common stock as of the first day of each semi-annual offering period or the fair market value of the stock at the end of the offering period. The Company issued 3,640 and 4,697 shares from treasury stock to employees under the ESPP during the years ended January 31, 2003 and 2002, respectively. At January 31, 2003, 189,128 shares were available for purchase under the ESPP.

The Company also has a Stock Incentive Plan (the "Plan"). The Plan provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, stock grants and stock purchase rights. A total of 1,000,000 shares of common stock have been reserved for issuance under the Plan. Only employee stock options and shares issued to directors have been issued under the Plan.

All of the stock options vest ratably over two to five-year periods, beginning one year after the date of the grant, and expire ten years after issuance. Since the exercise price of all of the options granted during the years ended January 31, 2003, 2002 and 2001 was at or above the fair market value per share of the Company's common stock at the dates of grant, no compensation expense relating to stock options was recorded. At January 31, 2003, options for 759,000 shares had been issued under the Plan. The following table is a summary of activity related to stock options for the respective years ended January 31:

	2003		2002		2001	
	Number Of Options	Weighted- Average Exercise Price	Number Of Options	Weighted- Average Exercise Price	Number Of Options	Weighted- Average Exercise Price
Outstanding at beginning of year	389,000	\$ 5.36	375,500	\$ 6.16	252,500	\$ 7.05
Granted	220,000	4.82	198,500	4.36	180,500	5.08
Exercised	(10,800)	4.31	-	-	-	-
Forfeited	-	-	(185,000)	5.90	(57,500)	6.72
Outstanding at end of year	<u>598,200</u>	<u>\$ 5.18</u>	<u>389,000</u>	<u>\$ 5.36</u>	<u>375,500</u>	<u>\$ 6.16</u>
Exercisable at end of year	<u>258,864</u>	<u>\$ 5.14</u>	<u>155,249</u>	<u>\$ 6.57</u>	<u>132,000</u>	<u>\$ 7.94</u>

The following table is a summary of information about stock options outstanding at January 31, 2003:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number Of Options	Weighted-Average Remaining Contractual Life	Weighted- Actual Average Exercise Price	Number Of Options	Weighted- Actual Average Exercise Price
\$ 4.31 - 6.00	548,200	8.1 years	\$ 4.74	208,864	\$ 4.82
10.00	50,000	4.4 years	10.00	50,000	10.00
<u>\$ 4.31 - \$10.00</u>	<u>598,200</u>	<u>7.8 years</u>	<u>\$ 5.18</u>	<u>258,864</u>	<u>\$ 5.14</u>

All of the Company's current directors elected to receive their compensation for the years ended January 31, 2003, 2002 and 2001 paid in the form of shares of the Company's common stock. The fair market value of the Company's common stock at the date of issuance was charged to expense with a corresponding decrease to treasury stock and additional paid-in capital. Such compensation expense totaled \$104, \$112 and \$72, and the number of shares issued was 22,517, 25,452 and 13,713 for the years ended January 31, 2003, 2002 and 2001, respectively. A total of 85,304 shares have been issued to directors under the Plan.

At January 31, 2003, 155,696 shares were available to be issued under the Plan.

In a series of authorizations commencing November 3, 1999, the Company's Board of Directors authorized a repurchase program of up to 2,118,817 shares of the Company's common stock. The repurchases have been funded from a portion of the proceeds from the sale of NAC, and were made from time to time in open market transactions, block purchases, privately negotiated transactions or otherwise at prices prevailing at the time of the repurchase.

During the years ended January 31, 2002 and 2001, respectively, the Company repurchased 1,100 and 1,023,398 shares of its common stock. The aggregate share repurchases since the repurchase program began totaled 2,024,498 and 2,023,398 shares at January 31, 2002 and 2001, respectively. The aggregate cost of the common shares repurchased was approximately \$10,708 and \$10,703, or \$5.29 per share both at January 31, 2002 and 2001, respectively. Approximately 94,000 shares still may be repurchased under this program.

In conjunction with the API acquisition, AMR Combs purchased 10,407 shares of API Series A Cumulative Convertible Preferred Stock, \$0.001 par value (the "Preferred Stock"), at a price of \$100 per share. Total adjusted proceeds to the Company were \$1,041. This transaction has been accounted for as minority interest in subsidiary in the accompanying consolidated balance sheets. Dividends are payable on a quarterly basis on the Preferred Stock at an annual rate of \$4.00 per share; accordingly, dividends of \$42 were paid during each of the years ended January 31, 2003, 2002 and 2001, respectively, and have been reflected as minority interest in subsidiary in the accompanying consolidated statements of operations. The Preferred Stock is convertible into ten percent of the common stock of API as of the date of conversion, prior to any dilution to the Preferred Stock.

Also in conjunction with the API acquisition, First Aviation, API and AMR Combs entered into a Stockholders Agreement. Pursuant to this agreement, API has the right to redeem the Preferred Stock at any time. Subject to certain terms and conditions, AMR Combs has the right to cause the Company to repurchase the Preferred Stock. The redemption price is equal to the fair market value of the Preferred Stock as determined by an independent appraisal. The Stockholders Agreement also contains certain other rights, including: (i) a right of first refusal on the part of First Aviation with respect to any proposed sale of the Preferred Stock; (ii) the right of First Aviation to require AMR Combs to participate, on a pro rata basis, with it in the sale of the capital stock of API to a third party; (iii) the right of AMR

Combs to elect to participate, on a pro rata basis, in the sale of the capital stock of API to a third party; and (iv) piggyback and demand registration rights granted to AMR Combs with respect to the Preferred Stock. The demand registration rights became exercisable in March 2000. If API has not previously closed an underwritten public offering of its common stock at the time AMR Combs elects to exercise its demand registration rights, API may elect to treat the demand as an exercise by AMR Combs of its put option with respect to the Preferred Stock. There are no plans to cause API to conduct a public offering of its securities.

On March 5, 1999, AMR Combs was acquired by Signature Flight Support, an affiliate of BBA Group Plc.

7. Income Taxes

The provision (benefit) for income taxes on continuing operations is as follows:

	Year ended January 31,		
	2003	2002	2001
Current:			
Federal	\$ -	\$ 236	\$ (201)
State	-	(42)	-
	-	194	(201)
Deferred:			
Federal	\$ 1,760	\$ -	\$ (191)
State	26	-	43
	1,786	-	(148)
Total provision (benefit)	\$ 1,786	\$ 194	\$ (349)

A reconciliation between the income tax provision (benefit) computed at the U.S. federal statutory rate and the effective rate reflected in the consolidated statements of operations is as follows:

	Year ended January 31,		
	2003	2002	2001
Provision (benefit) at federal statutory rate	(34.0)%	34.0%	(34.0)%
State tax provision (benefit), net of federal	(1.8)	(7.9)	3.1
Deferred tax valuation allowance	141.0	-	-
Non-deductible items	3.0	13.8	(6.8)
Prior year items	18.2	-	-
	126.4%	39.9%	(37.7)%

Deferred tax assets result from temporary differences in the recognition of income and expenses for tax and financial statement purposes. These differences are set forth below:

	January 31,	
	2003	2002
Financial statement accruals not currently deductible for income tax purposes, tax goodwill basis in excess of book, and net operating loss carryforwards	\$ 1,993	\$ 1,264
	<u>1,993</u>	<u>1,264</u>
Valuation allowance	<u>(1,993)</u>	<u>—</u>
Net deferred income tax assets	<u>\$ —</u>	<u>\$ 1,264</u>

For the first three quarters of the fiscal year ended January 31, 2003, the Company's results showed pre-tax income before the cumulative effect of the accounting change. As a result of the pre-tax loss incurred by the Company in the fourth quarter, the Company incurred a pre-tax loss before the effect of the accounting change for the full fiscal year. After considering this loss, the Company had incurred a cumulative loss over the prior three years. This cumulative loss triggered certain provisions under FAS 109, "Accounting for Income Taxes", that required the Company to re-evaluate its deferred income tax assets. As a result, the Company took a charge of \$1,993 to establish a valuation allowance against its deferred income tax assets since, under the provisions of FAS 109, a greater emphasis is placed on three-year cumulative losses as an indicator of the Company's ability to realize its deferred income tax assets than the potential for future income. The valuation allowance will be reversed in future years if financial results increase sufficiently to support the net book value of the assets. The increase in the deferred tax asset is due principally to the benefit from the Company's write-off of its goodwill. Based upon a number of factors, including the nature of the temporary differences and the timing of their reversal, the Company believed that the utilization of the deferred tax benefit at January 31, 2002 was more likely than not; therefore, a valuation reserve was not provided in that year. The Company has net operating loss carryforwards totaling approximately \$1,258 for federal income tax purposes. The carryforwards expire in 2021 and 2023.

## 8. Employee Benefits Plan

API maintains a defined contribution savings plan, qualified under Section 401(k) of the Internal Revenue Code, that covers substantially all of its full-time employees. The savings plan allows employees to defer up to 15 percent of their salary, with the Company partially matching employee contributions. Employees vest in the Company contribution ratably over three years. The Company expensed \$195, \$171 and \$143 related to the savings plan in the

years ended January 31, 2003, 2002 and 2001, respectively. Employees do not have an option to invest in the Company's stock under the savings plan.

## 9. Related Parties

Effective February 1, 2002 the Company, upon the authorization of the independent members of the Board of Directors, entered into a two-year advisory agreement with a related party and stockholder, First Equity Development Inc. ("First Equity"). The advisory agreement was a renewal of a prior agreement on substantially the same terms and conditions. Pursuant to the terms of this agreement, First Equity provides the Company with investment and financial advisory services relating to potential acquisitions and other financial transactions. The Company pays First Equity a \$30 monthly retainer, and reimburses First Equity for its out-of-pocket expenses. In addition, upon the successful completion of certain transactions, the Company will pay a fee to First Equity (the "Success Fee"). The amount of any Success Fee will be established by the independent members of the Board of Directors and will be dependent upon a variety of factors, including, but not limited to, the services to be provided, the size and the type of transaction. Up to one year's worth of retainer fees paid can be applied as a credit against any Success Fee, subject to certain limitations. During each of the years ended January 31, 2003 and 2001, respectively, the Company paid First Equity retainer fees of \$360. During the year ended January 31, 2002 the Company paid First Equity retainer fees of \$340, as First Equity voluntarily reduced the amount its retainer fees for the four months ended January 31, 2002. The aggregate total of retainer fees paid over the last three years was \$1,060. The agreement can be terminated by either party upon 30-days written notice to the other party.

In 1997 the Company entered into a ten-year sublease with First Equity for office space. The sublease is cancelable upon six months notice by either party. The Company has the option of renewing the sublease for two additional five-year periods. Payments under the sublease totaled approximately \$83, \$91 and \$95 for the years ended January 31, 2003, 2002 and 2001, respectively.

In addition, the Company paid an affiliate of First Equity approximately \$37 per year in each of the years ended January 31, 2003 and 2002, respectively, for printing and mailing services, and reimbursed the affiliate for actual expenses incurred. The services may be cancelled at any time.

## 10. Acquisition of Superior

On August 10, 2001 the Company completed the acquisition of the distribution business of Superior for \$4,614 in cash. Pursuant to the terms of the acquisition, the Company acquired the distribution business of Superior, including four distribution centers, approximately \$2,945 of inventory and equipment, and was named a worldwide distributor for Superior's product line of replacement parts for certain aircraft engines. The Company also entered into a five-year service agreement with Superior whereby the Company provides Superior with a variety of supply chain

management services for a fee based on the scope of services provided. The purchase price was allocated to the assets acquired, principally inventory, based upon their relative fair values. The excess of the purchase price paid over the fair value of the assets acquired, approximately \$2,242, was allocated to goodwill. In addition, the Company recorded approximately \$573 of accruals to cover the estimated costs to complete the acquisition and execute its plan to close the four distribution centers and consolidate facilities. Approximately \$386 of the accruals were paid prior to the year ended January 31, 2002. Substantially all of the remaining accruals were utilized during the year ending January 31, 2003.

The net incremental sales and gross profit from the Superior acquisition were not significant to consolidated results for the year ended January 31, 2002.

**11. Loss from Discontinued Operation and Gain from Dispositions of Subsidiaries**

Details of the loss from discontinued operation and gain from dispositions of subsidiaries, are as follows:

	Year ended January 31,		
	2003	2002	2001
Loss from discontinued operation – AeroV	\$ —	\$ —	\$ (1,847)
Gain from dispositions of subsidiaries:			
AeroV	\$ —	\$ 191	\$ (386)
NAC	—	769	979
	\$ —	\$ 960	\$ 593

**AeroV**

In February 2000 the Company established AeroV. The purpose of AeroV was to design a proprietary electronic procurement platform to enable electronic communication between the Internet and airlines’ legacy systems, in order to reduce supply chain costs. In December 2000 the Board of Directors of the Company reassessed its strategic position with respect to AeroV, and approved a plan to sell or dispose AeroV. The net loss of \$1,847 from the operations of AeroV for the year ended January 31, 2001, was net of a benefit for income taxes of \$1,100, and included a pre-tax asset impairment charge of \$1,245 to write-off the investment in AeroV. In addition, during the year ended January 31, 2001, the Company took a charge of \$386, net of a benefit for income taxes of \$199, to dispose of the operations of AeroV. AeroV had no significant sales during the year ended January 31, 2001.

In connection with the disposition of AeroV, the Company had accrued \$660 pre-tax for certain transaction, legal and other costs directly relating to the disposition. During the year ended January 31, 2002, \$306 was charged against the accruals and the Company reversed \$298 of accruals no longer

needed. This reversal, net of a provision for income taxes of \$107, for a net credit of \$191, was included in gain from dispositions of subsidiaries in the year ended January 31, 2002. At January 31, 2002, \$56 of the accruals remained. The accruals were completely utilized during the year ended January 31, 2003.

**NAC**

On November 1, 1999, the Company consummated the sale of the stock of NAC to Rolls-Royce North America, Inc. (“RRNA”) for \$73,000 in cash, subject to adjustment, pursuant to a Stock Purchase Agreement between First Aviation Services Inc. and Rolls-Royce North America, Inc. dated as of September 9, 1999 (the “Agreement”). During the year ended January 31, 2001, the sales price was adjusted down to \$70,950 to reflect a decrease in the net book value of the net assets sold. The difference was repaid to RRNA and had been accrued previously. NAC’s operations included the repair and overhaul of gas turbine engines and accessories, and the remanufacturing of engine components and accessories.

Pursuant to the Agreement, RRNA acquired substantially all of the assets and assumed certain liabilities of NAC, excluding income tax liabilities, debt, amounts due to parent (First Aviation) and any contingent liabilities resulting from NAC’s previous liquidation of its former qualified defined retirement benefit plan (the “NAC Plan”).

The Company recorded a net gain from the disposition of NAC during the year ended January 31, 2000. Included in the net gain on disposition the Company accrued \$3,700 for estimated transaction and other costs directly relating to the sale, excluding the estimated sales price adjustment. In addition, the Company accrued \$600 for estimated liabilities under the NAC Plan, whose liquidation had been audited by the Pension Benefit Guarantee Corporation, and who had challenged the amount paid to liquidate the NAC Plan (collectively, the “Accruals”).

First Aviation had been liable, without limitation, for any and all income taxes that might have been imposed upon NAC for all taxable periods ending on or prior to the date of sale.

Both First Aviation and RRNA were liable, without limitation, for any losses incurred relating to any breach of any representation or warranty made in the Agreement, and for any loss that occurs relating to matters specifically retained by the parties.

On February 28, 2001, the day prior to the expiration of most of the Company’s representations and warranties under the Agreement, RRNA filed a \$10 million claim for indemnification with the American Arbitration Association. The claim sought indemnification under provisions of the Agreement relating to environmental and non-environmental covenants and representations. Pursuant to the terms of the Agreement, the Company’s liability for indemnification claims had been limited to \$5 million for environmental and \$5 million for non-environmental claims (with limited exceptions related to taxes and other specified items).

On May 15, 2001, the Company and RRNA reached an agreement releasing the Company from any claim, cause of action or liability of any

nature whatsoever which has arisen, or thereafter may arise from any covenant, negligence, representation, warranty, indemnity, transaction, failure, omission or communication under the Agreement, and the arbitration was discontinued. In addition, RRNA assumed any exposure from the liquidation of the NAC Plan.

During the year ended January 31, 2001, the Company paid \$5,175 of estimated income tax liabilities that arose as a result of the sale. The \$979 difference between the estimated income tax liabilities previously recorded and the actual income tax liabilities paid was included in gain from dispositions of subsidiaries in the year ended January 31, 2001. During the year ended January 31, 2002, the Company reversed \$1,242 of the Accruals that were deemed unnecessary. The net credit of \$769, after applicable income taxes of \$473, was included in gain on dispositions of subsidiaries. At January 31, 2002, \$57 of the Accruals remained relating to the sale of NAC. The Accruals were completely utilized during the year ended January 31, 2003.

## 12. Net Income (Loss) per Share

The following sets forth the denominator used in the computation of basic earnings per share and earnings per share – assuming dilution.

	Years ended January 31,		
	2003	2002	2001
Denominator for basic net income (loss) per share – weighted average shares	7,224,532	7,197,941	7,720,520
Effect of dilutive warrants and employee stock options	<u>N/A</u>	<u>10,784</u>	<u>N/A</u>
Denominator for net income (loss) per share – assuming dilution – adjusted weighted average shares and assumed conversions	<u>7,224,532</u>	<u>7,208,725</u>	<u>7,720,520</u>

For the years ended January 31, 2003 and 2001, the denominator used in the calculation of loss per share from continuing operations – assuming dilution, was the same as the denominator used for basic loss per share because the effect of warrants and options would have been antidilutive.

## 13. Commitments and Contingencies

### Commitments

The Company leases certain warehouse facilities, equipment and office space. Certain of the Company's operating leases have options which allow the Company, at the end of the initial lease term, to renew the leases for periods ranging from three to five years. Certain lease agreements also contain escalation clauses that are based on the consumer price index. Future minimum rental payments under operating leases that have initial noncancelable lease terms in excess of one year as of January 31, 2003 are as follows:

Year ending January 31, 2004	\$ 758
Year ending January 31, 2005	741
Year ending January 31, 2006	604
Year ending January 31, 2007	632
Year ending January 31, 2008	636
Thereafter	<u>2,373</u>
	<u>\$ 5,744</u>

Future minimum rental payments for the years ended January 31, 2004 through January 31, 2006 are net of sublease income of \$65. Rental expense under noncancelable operating leases amounted to \$982, \$918, and \$830 for the years ended January 31, 2003, 2002 and 2001, respectively.

### Contingencies

In the ordinary course of business, the Company is subject to many levels of governmental inquiry and investigation. Among the agencies that oversee the Company's business activities are the Federal Aviation Administration, the Department of Transportation and the Environmental Protection Agency. The Company does not anticipate that any action as a result of such inquiries and investigations would have a material adverse affect on its consolidated financial position, results of operations, or its ability to conduct business.

In the normal conduct of its business, the Company also is involved in various claims and lawsuits, none of which, in the opinion of the Company's management, will have a material adverse impact on the Company's consolidated financial position. The Company maintains what it believes is adequate liability and other insurance to protect it from such claims. However, depending on the amount and timing, unfavorable resolution of any of these matters could have a material effect on the Company's consolidated financial position, results of operations or cash flows in a particular period.

During the fourth quarter ended January 31, 2002, the Company settled litigation previously initiated against Gulf Insurance Company for a cash payment to the Company of \$950. The income was shown separately net of associated legal expenses on the consolidated statements of operations for the year ended January 31, 2002.

**14. Quarterly Financial Information (unaudited)**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter (1)
<i>Year ended January 31, 2003</i>				
Net sales	\$ 24,998	\$ 26,165	\$ 26,611	\$ 23,963
Gross profit	4,674	4,924	5,131	3,744
Income (loss) before cumulative effect of accounting change	78	(145)	121	(3,253)
Cumulative effect of accounting change	(2,735)	-	-	-
Net income (loss)	(2,657)	(145)	121	(3,253)
Basic income (loss) per share before cumulative effect of accounting change	\$ 0.01	\$ (0.02)	\$ 0.02	\$ (0.45)
Basic and diluted net income (loss) per share	\$ (0.37)	\$ (0.02)	\$ 0.02	\$ (0.45)

(1) Fourth quarter results include the impact of a non-cash charge of \$804 to increase the allowance for doubtful trade receivables, and a non-cash income tax charge \$1,993 to establish a valuation allowance against the Company's deferred income tax assets. See Notes 2 and 7 for further explanation.

<i>Year ended January 31, 2002</i>				
Net sales	\$ 25,571	\$ 27,564	\$ 26,953	\$ 25,608
Gross profit	4,636	4,904	4,722	4,754
Income (loss) from continuing operations	87	70	(490)	625
Net income (loss)	87	777	(490)	878
Basic and diluted income (loss) per share from continuing operations	\$ 0.01	\$ 0.01	\$ (0.07)	\$ 0.09
Basic and diluted net income (loss) per share	\$ 0.01	\$ 0.11	\$ (0.07)	\$ 0.12

### **Corporate Headquarters**

First Aviation Services Inc.  
15 Riverside Avenue  
Westport, CT 06880-4214  
Phone: (203) 291-3300  
Fax: (203) 291-3330  
E-mail: investorrelations@firstaviation.com  
Website: www.favs.com

### **Transfer Agent and Registrar**

American Stock Transfer &  
Trust Company  
59 Maiden Lane  
New York, NY 10038  
Phone: (212) 936-5100

### **Independent Auditors**

Ernst & Young LLP  
Stamford, CT 06905

### **Common Stock**

The common stock of First Aviation Services Inc. is listed on NASDAQ under the symbol FAVS.

### **SEC Forms and Shareholder Inquiries**

First Aviation Services welcomes inquiries from shareholders, analysts and prospective investors. A copy of the Company's Annual Report on Form 10-K and Quarterly Reports on Form 10-Q as filed with the Securities and Exchange Commission may be furnished free of charge upon request to our headquarters, or may be found on our website (www.favs.com). In addition, research analysts are invited to join our e-mail and fax list to receive recent news and information about upcoming conference calls.

### **Board of Directors**

*Aaron P. Hollander*<sup>2,3</sup>  
Chairman of the Board  
First Aviation Services Inc.  
  
President and Co-Chief Executive Officer  
First Equity Group Inc.  
  
President and Chief Executive Officer  
Skip Barber Racing School, LLC  
  
Chairman of the Board of Directors  
Imtek, Inc.

*Michael C. Culver*<sup>3</sup>  
President and  
Chief Executive Officer  
First Aviation Services Inc.

Chairman of the Board of Directors  
Aerospace Products International, Inc.  
  
Co-Chief Executive Officer  
First Equity Group Inc.

*Stanley J. Hill*<sup>1</sup>  
Retired President, Chief Executive  
Officer and Chairman of the  
Board of Directors  
Kaiser Aerospace and Electronics  
Corporation and its parent, K Systems, Inc.

*Robert L. Kirk*<sup>1,2</sup>  
Retired Chairman of the  
Board of Directors  
British Aerospace Holdings, Inc.

*Joseph J. Lhota*<sup>1</sup>  
Executive Vice President,  
Corporate Administration  
Cablevision Systems Corporation

<sup>1</sup> Member of Audit Committee

<sup>2</sup> Member of Compensation Committee

<sup>3</sup> Member of Executive Committee

### **Principle Officers**

*Michael C. Culver*  
President and Chief Executive Officer  
First Aviation Services Inc.

*Gerald E. Schlesinger*  
Senior Vice President  
First Aviation Services Inc.

President and Chief Executive Officer  
Aerospace Products International, Inc.

*Michael D. Davidson*  
Vice President, Finance,  
Chief Financial Officer and Secretary  
First Aviation Services Inc.



## COMMITMENT TO ETHICS

*FAvS believes that ethics are everyone's responsibility. We are committed to the highest ethical standards, and we demonstrate these beliefs to our employees, our customers, our community and our suppliers. At FAvS, our foundation is **Integrity**, our strength is **Teamwork**, and our goal is **Excellence**.*

### **Join the Team**

FAvS is a worldwide leader in providing services, parts and components to aircraft operators of some of the most widely used governmental, commercial, corporate and general aviation aircraft. Due to continued growth, FAvS is always looking for experienced and energetic individuals who are seeking an excellent career opportunity. If you would like to be a member of "Team FAvS" please mail your resume to the attention of:

Employment Opportunities  
First Aviation Services Inc.  
15 Riverside Avenue  
Westport, CT 06880-4214  
[www.favs.com](http://www.favs.com)

For opportunities with API please visit the website at [www.apiparts.com](http://www.apiparts.com), or write to:

Director of Human Resources  
Aerospace Products International, Inc.  
3778 Distriplex Drive North  
Memphis, TN 38118

We look forward to hearing from you.

### Forward-Looking Statements

Certain statements discussed in this Annual Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical facts, but rather reflect the Company's current expectations concerning future events and results. Such forward-looking statements, including those concerning the Company's expectations, involve known and unknown risks, uncertainties and other factors, some of which are beyond the Company's control, that may cause the Company's actual results, performance or achievements, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others: the Company's ability to obtain parts and components from its principal suppliers on a timely basis; depressed domestic and international market and economic conditions, especially those currently facing the aviation industry as a whole; the impact of changes in fuel and other freight-related costs; relationships with its customers; the ability of the Company's customers to meet their financial obligations to the Company; the ability to obtain and service supply chain management contracts; changes in regulations or accounting standards; the ability to consummate suitable acquisitions and expand; other items that are beyond the Company's control which may cause actual results to differ from management's expectations; and other factors as are described in Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) in the Company's Annual Report on Form 10-K for the year ended January 31, 2003. In addition, specific consideration should be given to the various factors described in this Annual Report.



**FIRST AVIATION SERVICES INC.**

15 Riverside Avenue  
Westport, Connecticut 06880-4214  
Tel: 203-291-3300  
Fax: 203-291-3330  
E-mail: [investorrelations@firstaviation.com](mailto:investorrelations@firstaviation.com)  
Websites: [www.favs.com](http://www.favs.com)  
[www.apiparts.com](http://www.apiparts.com)

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