

First Aviation Services Inc.

Consolidated Financial Statements

For the Eleven Months Ended December 31, 2009
and Year Ended January 31, 2009

First Aviation Services Inc.

Index

For the Eleven Months Ended December 31, 2009 and Year Ended January 31, 2009

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DIXON HUGHES PLLC
Certified Public Accountants and Advisors

Independent Auditors' Report

The Board of Directors and Stockholders
First Aviation Services Inc.

We have audited the accompanying consolidated balance sheets of First Aviation Services Inc. and Subsidiaries (the "Company") as of December 31, 2009 and January 31, 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for the eleven months ended December 31, 2009 and year ended January 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the December 31, 2009 and January 31, 2009 financial statements of API Asia Pacific, Inc. and API China, Inc. (wholly-owned subsidiaries) with assets of \$4,473,757 and \$3,484,155 at December 31, 2009 and January 31, 2009, respectively, revenues of \$12,304,214 and \$10,277,887, for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively, and net income of \$527,004 for the eleven months ended December 31, 2009 and net loss of \$166,712 for the year ended January 31, 2009. The December 31, 2009 and January 31, 2009 financial statements of API Asia Pacific, Inc. and API China, Inc. were audited by other auditors whose reports were furnished to us, and our opinion, insofar as it relates to the amounts included for API Asia Pacific, Inc. and API China, Inc. is based solely on the reports of other auditors.

We conducted audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of First Aviation Services Inc. and Subsidiaries as of December 31, 2009 and January 31, 2009, and the consolidated results of their operations and their cash flows for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively, in conformity with accounting principles generally accepted in the United States of America.

The supplemental schedule on page 24 is presented for the purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and, accordingly, we express no opinion on it.

May 13, 2010

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First Aviation Services Inc.

Consolidated Balance Sheets (in thousands, except share and per share amounts)

December 31, 2009 and January 31, 2009

	<u>December 31, 2009</u>	<u>January 31, 2009</u>
Assets		
Current assets:		
Cash	\$ 1,033	\$ 1,304
Trade receivables, net	17,878	13,985
Miscellaneous receivables	847	507
Inventories, net	37,604	29,471
Prepaid expenses and other	2,251	1,362
Total current assets	59,613	46,629
Plant and equipment, net	2,663	3,253
Deferred financing costs and other	194	-
Goodwill	11,488	-
Total assets	\$ 73,958	\$ 49,882
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 17,091	\$ 11,651
Accrued compensation and related expenses	407	290
Other accrued liabilities	3,378	1,280
Revolving line of credit	21,326	20,630
Time loan payable	7,000	-
Note payable	432	537
Total current liabilities	49,634	34,388
Long-term liabilities	649	-
Subordinated debt:		
Related party - JEM III LLC	-	2,000
Total liabilities	50,283	36,388
Stockholders' equity		
Class A Common stock, \$0.01 par value, 10,000,000 shares authorized (increased to 20,000,000 shares authorized in December 2009), 11,320,628 and 9,135,699 shares issued, respectively, 9,838,234 and 7,534,569 shares outstanding, respectively	91	91
Class B Common stock, \$0.01 par value, 6,000,000 shares authorized 5,766,667 and -0- shares issued, respectively, 5,766,667 and -0- shares outstanding, respectively	58	-
Preferred stock, \$0.01 par value, \$100 redemption value, 30,000 shares authorized, 13,500 and -0-, shares issued, respectively, 13,500 and -0- shares outstanding, respectively	1,350	-
Additional paid-in capital	46,754	38,288
Deficit	(17,296)	(16,761)
Accumulated other comprehensive income	390	229
	31,347	21,847
Less: treasury stock, at cost, 1,482,394 and 1,601,130 shares, respectively	(7,672)	(8,353)
Total stockholders' equity	23,675	13,494
Total liabilities and stockholders' equity	\$ 73,958	\$ 49,882

See notes to consolidated financial statements.

First Aviation Services Inc.

Consolidated Statements of Operations (in thousands, except share and per share amounts)

For the Eleven Months Ended December 31, 2009 and for the Year Ended January 31, 2009

	December 31, 2009	January 31, 2009
Net sales	\$ 100,332	\$ 114,244
Cost of sales	(83,068)	(95,037)
Gross profit	17,264	19,207
Selling, general and administrative expenses	13,955	18,723
Corporate expenses	2,037	1,647
Acquisition expenses	683	-
	16,675	20,370
Income (loss) from operations	589	(1,163)
Non-operating income (expense)		
Interest income	2	3
Interest expense and other, net	(1,126)	(1,374)
Net loss	\$ (535)	\$ (2,534)
Dividends on preferred stock	\$ (15)	\$ -
Loss attributable to common stockholders	\$ (550)	\$ (2,534)
<i>Basic net loss per share, and net loss per share - assuming dilution:</i>		
Basic net loss per share	\$ (0.07)	\$ (0.34)
Net loss per share - assuming dilution	\$ (0.07)	\$ (0.34)
Weighted average shares outstanding - basic	8,250,906	7,465,583
Weighted average shares outstanding - assuming dilution	8,250,906	7,465,583

See notes to consolidated financial statements.

First Aviation Services, Inc.

Consolidated Statements of Stockholders' Equity
(in thousands, except share amounts)

For the Eleven Months Ended December 31, 2009 and Year Ended January 31, 2009

Comprehensive Income (Loss)	Class A Common Stock		Class B Common Stock		Preferred Stock		Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Sub-Total	Treasury Stock		Total
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount					Number of Shares	Amount	
Balances at February 1, 2008	7,421,925	\$ 91	-	\$ -	-	\$ -	\$ 38,782	\$ (14,227)	\$ 835	\$ 25,481	1,713,774	\$ (9,014)	\$ 16,467
Shares issued to directors	77,634	-	-	-	-	-	(575)	-	-	(575)	(77,634)	661	86
Other equity based compensation	35,010	-	-	-	-	-	81	-	-	81	(35,010)	-	81
Other comprehensive loss	\$ (606)	-	-	-	-	-	-	-	(606)	(606)	-	-	(606)
Net loss	(2,534)	-	-	-	-	-	-	(2,534)	-	(2,534)	-	-	(2,534)
<u>\$ (3,140)</u>													
Balances at January 31, 2009	7,534,569	91	-	-	-	-	38,288	(16,761)	229	21,847	1,601,130	(8,353)	13,494
Shares issued to directors	101,231	-	-	-	-	-	(510)	-	-	(510)	(101,231)	563	53
Shares issued for the purchase of Piedmont Propulsion Systems	-	-	5,766,667	58	7,500	750	7,292	-	-	8,100	-	-	8,100
Shares issued for the conversion of debt to equity	2,184,929	-	-	-	6,000	600	1,749	-	-	2,349	-	-	2,349
Other equity based compensation	17,505	-	-	-	-	-	(65)	-	-	(65)	(17,505)	118	53
Other comprehensive income	\$ 161	-	-	-	-	-	-	-	161	161	-	-	161
Net loss	(535)	-	-	-	-	-	-	(535)	-	(535)	-	-	(535)
<u>\$ (374)</u>													
Balances at December 31, 2009	<u>9,838,234</u>	<u>\$ 91</u>	<u>5,766,667</u>	<u>\$ 58</u>	<u>13,500</u>	<u>\$ 1,350</u>	<u>\$ 46,754</u>	<u>\$ (17,296)</u>	<u>\$ 390</u>	<u>\$ 31,347</u>	<u>1,482,394</u>	<u>\$ (7,672)</u>	<u>\$ 23,675</u>

See notes to consolidated financial statements.

First Aviation Services Inc.

Consolidated Statements of Cash Flows (in thousands)

For the Eleven Months Ended December 31, 2009 and Year Ended January 31, 2009

	December 31, 2009	January 31, 2009
Cash flows from operating activities		
Net loss	\$ (535)	\$ (2,534)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	945	1,521
Equity based compensation	106	167
Provision for bad debts	(75)	(142)
Provision for excess and obsolete inventory	26	(1,011)
(Gain) loss on sale of plant and equipment	-	(5)
Change in working capital assets/liabilities:		
Trade receivables	(2,256)	2,746
Inventories	(4,445)	795
Prepaid expenses and other assets	(1,051)	53
Accounts payable	3,937	997
Other liabilities	2,633	(1,021)
	(715)	1,566
Cash flows from investing activities		
Purchases of plant and equipment and other assets	(79)	(702)
Net cash used in investing activities	(79)	(702)
Cash flows from financing activities		
Borrowings (repayments) on revolving line of credit, net	696	256
Repayments on note payable	(105)	(506)
Net cash provided by (used in) financing activities	591	(250)
Effect of exchange rate changes on cash and cash equivalents	(68)	(60)
Net change in cash and cash equivalents	(271)	554
Cash and cash equivalents at the beginning of the year	1,304	750
Cash and cash equivalents at the end of the year	\$ 1,033	\$ 1,304
Supplemental cash flow disclosures		
Cash paid for:		
Interest	\$ 2,313	\$ 1,238
Income taxes paid, net	\$ -	\$ -

See notes to consolidated financial statements.

First Aviation Services Inc.

Notes to Consolidated Financial Statements

(amounts in thousands, except share and per share amounts)

1. Business

First Aviation Services Inc. ("First Aviation"), through its wholly-owned subsidiaries, FAvS, Inc. Aerospace Products International, Inc. ("API"), Aerospace Products International, Ltd. (Canada) ("API Ltd."), API Asia Pacific, Inc. ("API Asia Pacific"), API Europe, Ltd. ("API Europe"), API China, Inc. ("API China"), Aerospace Turbine Rotables, Inc. ("AeTR"), and Piedmont Propulsion Systems, LLC ("PPS") (collectively the "Company"), is one of the leading 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 and builds custom hose assemblies. The Company has its headquarters in Westport, Connecticut.

2. Summary of Significant Accounting Policies

Consolidation

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

Fiscal Year

The Company changed its year end from January 31 to December 31 during the 2009 calendar year resulting in consolidated financial statements as of and for the eleven months ended December 31, 2009 and year ended January 31, 2009.

Business Combinations

First Aviation, through its subsidiaries AeTR and PPS, acquired the assets of Kelly Turbine Rotables ("Kelly") representing its aftermarket repair and overhaul business and the propeller overhaul division of Piedmont Aviation Component Services ("Piedmont"), respectively, on December 4, 2009. The business combinations are consistent with the Company's growth strategies and complementary to the Company's existing business platform. The business combinations were accounted for using the acquisition method which requires an acquirer to recognize the assets acquired and the liabilities assumed, measured at their fair values as of that date. In addition, this guidance requires that all acquisition related costs be expensed as incurred, rather than capitalized as part of the purchase price.

2. Summary of Significant Accounting Policies (continued)

As discussed in Notes 3 and 5, the Kelly acquisition was paid for in cash through proceeds from the Company's line of credit. As discussed in Note 3, the Piedmont acquisition was paid for through the issuance of the Company's Class B common stock and Series A preferred stock. The results of operations of Kelly and Piedmont have been included in the consolidated financial statements since the date of acquisition. The following summarizes the components of the acquisition date fair values:

	<u>Kelly</u>	<u>Piedmont</u>	<u>Total</u>
Cash	\$ 1	\$ -	\$ 1
Accounts receivable	831	1,071	1,902
Prepays	16	16	32
Inventory	2,038	1,676	3,714
Property and equipment	152	124	276
Accounts payable and accrued expenses	(562)	(1,751)	(2,313)
Goodwill	4,524	6,964	11,488
Total	<u>\$ 7,000</u>	<u>\$ 8,100</u>	<u>\$ 15,100</u>

A substantial portion of the purchase price was paid for goodwill due to the estimated future earnings potential associated with the businesses.

Pro forma information related to the acquisitions is not presented as the Company has determined that it is impractical to do so given the historical reporting of these operations. Annual revenues for the combined operations are approximately \$20,000.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

Revenue Recognition

The Company's net sales consist of sales and services to the aviation industry, including parts and components supply services, supply chain management services, and component overhaul and repair 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. 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

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

customers' inventory without taking ownership of such inventory. The Company, when providing services to handle customers' inventory without taking ownership, takes a fee based on the cost of providing services, and not on the sales value of the product.

Accounts Receivable

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. Management considers accounts to be past due at the point invoices extend beyond their credit term. Interest or other finance charges are not charged on past due accounts. The Company performs ongoing credit evaluations of its customers and maintains allowances that management believes are adequate for potential credit losses. The allowance for doubtful accounts was \$718 and \$1,013 at December 31, 2009 and January 31, 2009, respectively.

Inventories

Inventories generally consist of aircraft parts and components and are stated at the lower of cost, using the average cost method, or market. Provisions are made for the estimated effect of obsolete and slow moving inventories using a methodology based upon financial formulas that take into account quantities, costs, the age of the inventory on hand, historical and projected sales, and other inventory movements, adjusted for known or estimated factors such as new product lines and product return allowances. The allowance for obsolete and slow moving inventories was \$3,904 and \$4,425 at December 31, 2009 and January 31, 2009, respectively.

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 are amortized over the shorter of the estimated life of the improvement or the term of the related lease.

Long-Lived Assets

Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. Impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets is less than the carrying value. If impairment exists, an

2. Summary of Significant Accounting Policies (continued)

Long-Lived Assets (continued)

impairment loss is recognized as the difference between the carrying value of the asset and its fair value. Fair value is determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. No asset impairments were recorded during the period ended December 31, 2009 and year ended January 31, 2009.

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 when it is more likely than not that the deferred tax assets will not be realized.

The Company recognizes liabilities for uncertain income tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires management to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as management must determine the probability of various possible outcomes. Management reevaluates these uncertain tax positions on a quarterly basis or when new information becomes available. These reevaluations are based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, successfully settled issues under audit, and new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an increase to the tax accrual.

If applicable, interest related to income tax liabilities is included in interest expense and penalties are recognized as a component of income tax expense.

Accumulated Other Comprehensive Income

The accumulated other comprehensive income arose from the translation of accounts into U. S. dollars where the functional currency is the Canadian dollar (API Ltd.).

Advertising

Advertising costs are expensed as incurred and amounted to \$440 and \$635 for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively.

2. Summary of Significant Accounting Policies (continued)

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.

Concentration Risks

The Company has bank deposits in excess of federal deposit insurance.

API has five suppliers from whom approximately 36% and 40% of its total purchases were made during the period ended December 31, 2009 and year ended January 31, 2009, respectively. Accounts payable to these vendors totaled \$9,395 and \$1,432 at December 31, 2009 and January 31, 2009, respectively, with the increase due to a new distribution agreement.

Goodwill and Other Intangible Assets

The Company follows applicable accounting guidance for goodwill and other intangible assets which requires that goodwill (and intangible assets deemed to have indefinite lives) be subject to at least an annual impairment test. The Company tests for impairment on an annual basis or more frequently when events and circumstances indicate that an impairment may have occurred. The Company does not believe that there were any facts or circumstances which indicated an impairment has occurred at December 31, 2009. Other intangible assets with finite lives are amortized on a straight line basis over their useful lives.

Deferred Financing Costs

Deferred financing costs consist of financing fees and costs associated with the modification of the line of credit during the eleven months ended December 31, 2009 and are being amortized over twelve months, which is the term of the debt.

Share-Based Payments

The Company has certain stock-based compensation, as more fully described in Note 7. In accordance with accounting guidance for share-based payments, compensation expense (based upon the fair value on the date of grant) is recognized in the consolidated statement of operations over the requisite service period, which, for the Company, is generally the vesting period, for all new awards and unvested awards that are expected to vest over the service period.

Fair Value Measurements

Accounting guidance for fair value measurements was adopted by the Company effective on February 1, 2008. This guidance defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America and expands disclosures

2. Summary of Significant Accounting Policies (continued)

Fair Value Measurements (continued)

about fair value measurements. The guidance had a one-year deferral as it related to financial assets and liabilities measured at fair value on a nonrecurring basis. The Company implemented the deferred guidance as of February 1, 2009. The adoption of this guidance had no impact on the Company's consolidated financial statements for the eleven months ended December 31, 2009 and year ended January 31, 2009.

The carrying values of current assets and liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The carrying amount of the Company's borrowings under its debt agreements approximates fair value, as the incremental borrowing rates approximate current rates.

Reclassifications

Certain fiscal January 31, 2009 amounts have been reclassified to conform to their December 31, 2009 presentation. The effect of the reclassifications did not impact the consolidated financial position or results of operations of the Company.

Subsequent Events

The Company evaluated the effect subsequent events would have on the consolidated financial statements through May 13, 2010, which is the date the consolidated financial statements were available to be issued.

3. Non-Cash Transactions

The Company purchased Piedmont with issuance of its Class B common stock and preferred stock which was valued at \$8,100 by independent appraisal. The Company purchased Kelly with \$7,000 issued directly from the conversion of a portion of the Revolving Line of Credit to a time loan. The Company also converted a subordinated loan to stock as discussed in Note 5.

4. Plant and Equipment

Plant and equipment consist of the following:

	<u>12/31/09</u>	<u>1/31/09</u>
Machinery and equipment	\$ 3,304	\$ 2,434
Buildings and leasehold improvements	1,509	1,051
Computer equipment, software, office furniture, Fixtures, vehicles, and other office equipment	13,250	12,814
Construction-in-process	<u>94</u>	<u>56</u>
	18,157	16,355
Less: accumulated depreciation	<u>(15,494)</u>	<u>(13,102)</u>
	<u>\$ 2,663</u>	<u>\$ 3,253</u>

4. Plant and Equipment (continued)

The amount of the unamortized capitalized software at December 31, 2009 and January 31, 2009 was \$1,250 and \$1,750, respectively. The related amortization expense during the eleven months ended December 31, 2009 and year ended January 31, 2009 was \$500 and \$887, respectively. The Company changed its estimate of the remaining useful life of its enterprise software during the year ended January 31, 2009, which decreased amortization expense by \$121.

5. Revolving Loan Facility and JEM III LLC Subordinated Debt

	<u>12/31/09</u>	<u>1/31/09</u>
Revolving line of credit	\$ 21,326	\$ 20,630
Time loan payable	7,000	-
Subordinated debt	-	2,000
	<u>\$ 28,326</u>	<u>\$ 22,630</u>

On November 2, 2007, the Company entered into a Master Affirmation and Second Amendment to Loan Documents (the "Second Amendment") with TD Bank, NA. The Second Amendment provides for a 36-month senior revolving credit facility (the "Revolving Loan Facility") in the amount of \$32,000, subject to a borrowing base based on a formula of qualifying assets as well as outstanding letters of credit, and expires on September 1, 2010. The proceeds of any loans made under the Revolving Loan Facility will be used for working capital purposes in the ordinary course of business. Changes to the debt service coverage ratios and interest rate pricing were also modified as a result of the Second Amendment.

On May 19, 2008, the Company entered into a Master Affirmation and Third Amendment to Loan Documents (the "Third Amendment") which amends the Agreement by providing: a waiver of certain covenant defaults for the periods ended October 31, 2007 and January 31, 2008; an amendment to certain covenants; and the ability by borrower to use up to \$500 of the Revolving Credit Facility to finance redemption of equity interests.

On October 23, 2009, the Company entered into a Master Reaffirmation and Fourth Amendment to Loan Documents (the "Fourth Amendment") which amends the Agreement by providing: a waiver of certain covenant defaults for the periods ended January 31, 2009 and April 30, 2009; and an amendment of certain covenants.

On December 3, 2009, the Company entered into the Third Amended and Restated Loan and Security Agreement which gives the bank's consent to the Company's reorganization- conversion of subordinated debt and authorization of preferred stock; gives the bank's consent to the Company's acquisition of Kelly and Piedmont; converts \$7,000 of the Revolving Credit Facility to a non-restoring time loan for the Kelly acquisition (Piedmont Aviation Component Services ("PACS") has issued a guarantee for the \$7,000 time loan); includes AeTR and PPS in the use of the Revolving Credit Facility for working capital needs as well as their inclusion in the borrowing base; permits the Company to secure (any future) debt to PACS with subordinate liens in relation to PACS' guarantee of the \$7,000 time loan; and amends certain other terms and conditions of the existing agreement. The

5. Revolving Line of Credit and JEM III LLC Subordinated Debt (continued)

time loan is due in monthly installments of \$100,000 beginning June 1, 2010 with the remaining balance due September 1, 2010.

Prior to June 30, 2009, the Revolving Loan Facility bore interest at the option of the borrower (i) at the prime rate in effect from time to time, (ii) at the adjusted LIBOR for the applicable interest period plus 150, 175, 200, or 225 basis points depending upon financial ratios of the borrower, or (iii) at the FHLB Rate (the "Federal Home Loan Bank Rate"). Effective July 1, 2009, the interest rate changed to adjusted LIBOR (as defined) plus 450 basis points, with a minimum rate of 6.50%. The Agreement contains numerous covenants, including restrictions on mergers, consolidations and acquisitions, the incurrence of indebtedness, transactions with affiliates, the creation of liens, and limitations on capital expenditures (subject to the bank's consent). Pursuant to the terms and conditions of the Agreement, the payment of dividends on the Company's stock is prohibited, except with the bank's consent (which has been provided for the Series A preferred stock issued in connection with the Piedmont acquisition and subordinated debt conversion), and the Company is required to maintain minimum levels of Tangible Capital Base and specified Debt Service Coverage. Substantially all of the Company's domestic and Canadian assets are pledged as collateral under the Agreement, and the Company guarantees all borrowings under the Agreement. The Company was in compliance with the covenants at December 31, 2009.

The Revolving Loan Facility is classified as current debt based upon the subjective acceleration clause and required lockbox cash management agreement. The Company expects to renew or extend this credit facility prior to expiration on September 1, 2010.

JEM III LLC, a related party, provided a subordinated loan to the Company up to \$5,000 to fund operations, which provided an option for the debt to be converted to shares of the Company's stock. Interest on the subordinated loan was at LIBOR plus 500 basis points. Accrued interest payable at January 31, 2009 was \$247. Effective December 3, 2009, in conjunction with the acquisitions of Kelly and Piedmont, the loan balance and accrued interest (totaling \$2,348) was converted into shares of the Company's Class A common stock and Series A preferred stock.

6. Note Payable and Long-Term Liabilities

	<u>12/31/09</u>	<u>1/31/09</u>
Note payable - current	\$ 349	\$ 537

API entered into an initial parts purchase agreement on September 20, 2005, with a leading aircraft original equipment manufacturer ("OEM") to purchase inventory and sell parts. The promissory note was for a term of 4 years, at 5.0% interest per annum payable quarterly through October 2009. The promissory note was subordinated to the Company's Revolving Line Facility. At the end of the term of the note, the Company was in dispute with the OEM over certain matters and delayed payment of the remainder of the note (expected to be paid in 2010). Final payment of the amount outstanding is expected once the matter is resolved.

Long-term liabilities relate to normal inventory purchases that have associated trade payables with payment terms beyond 12 months.

7. Share-Based Payments

The Company has a Stock Incentive Plan (the "Plan") with a total of 1,200,000 shares of common stock reserved for issuance. The Plan provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, stock grants and stock purchase rights. At December 31, 2009, 779,258 shares (after forfeitures) have been issued under the Plan.

The Company's non-employee directors receive a portion of their annual compensation in 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 value per share at the date issued. The Company's non-employee directors receive compensation in cash for committee meetings and special board meetings, excluding the four regularly scheduled board meetings and the annual shareholders' meeting that are paid for in stock as part of their annual compensation.

Compensation expense related to non-employee directors totaled \$54 and \$86, and the number of shares issued was 101,231 and 77,634 for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively. A total of 419,293 and 318,979 shares have been issued to directors under the Plan.

The Company has issued restricted stock awards to its President as follows:

	<u>12/31/09</u>		<u>1/31/09</u>	
	<u>Number of Shares</u>	<u>Grant Date Fair Value</u>	<u>Number of Shares</u>	<u>Grant Date Fair Value</u>
Outstanding (nonvested) at beginning of period/year	33,045	\$ 2.16	56,385	\$ 2.16
Granted	-	-	-	-
Vested	<u>(23,340)</u>	<u>2.16</u>	<u>(23,340)</u>	<u>2.16</u>
Outstanding (nonvested) at end of period/year	<u>9,705</u>	<u>\$ 2.16</u>	<u>33,045</u>	<u>\$ 2.16</u>

Compensation expense related to the restricted stock awards totaled \$51 and \$51, for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively. The number of shares issued as of December 31, 2009 was 52,515; 17,505 and 35,010 for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively.

As of December 31, 2009, \$21 of unrecognized cost related to nonvested restricted stock awards is expected to be recognized in fiscal 2010.

The Company generally grants stock options to its employees for a fixed number of shares with an exercise price equal to the fair value of the stock on the date of grant. The fair value of the stock options granted was estimated at the date of grant using a Black-Scholes option-pricing model.

7. Share-Based Payments (continued)

The fair value of each option granted was estimated at the date of grant using the following assumptions for the eleven months ended December 31, 2009 and year ended January 31, 2009:

	<u>12/31/09</u>	<u>1/31/09</u>
Expected dividend yield	0.0%	0.0%
Average risk-free interest rate	2.2%	2.9%
Expected volatility	33.0%	33.0%
Expected life of option	5 years	5 years
Weighted average fair value of options granted during the period	\$.17	\$.51

All of the stock options vest ratably over two to three-year periods, beginning one year after the date of the grant, and expire ten years after issuance. The following table is a summary of activity related to stock options for the eleven months ended December 31, 2009 and year ended January 31, 2009:

	<u>12/31/09</u>		<u>1/31/09</u>	
	Number of <u>Options</u>	Weighted Average Exercise <u>Price</u>	Number of <u>Options</u>	Weighted Average Exercise <u>Price</u>
Outstanding at beginning of period/year	111,650	\$ 2.66	132,150	\$ 3.32
Granted	85,000	.58	15,000	1.50
Exercised	-	-	-	-
Forfeited	<u>(15,000)</u>	1.50	<u>(35,500)</u>	4.63
Outstanding at end of period/year	<u>181,650</u>	1.85	<u>111,650</u>	2.66
Exercisable at end of period/year	<u>74,983</u>	2.86	<u>43,317</u>	3.25

The aggregate intrinsic value of options outstanding and exercisable at December 31, 2009 was \$17.

The weighted average remaining contractual term of options outstanding and exercisable at December 31, 2009 is 6.8 years.

	<u>12/31/09</u>		<u>1/31/09</u>	
	Number of <u>Options</u>	Weighted Average Exercise <u>Price</u>	Number of <u>Options</u>	Weighted Average Exercise <u>Price</u>
Nonvested at beginning of the period/year	68,333	\$ 4.91	80,000	\$ 2.49
Granted	85,000	.58	15,000	1.50
Vested	(31,666)	2.32	(26,667)	4.25
Forfeited	<u>(15,000)</u>	1.50	-	-
Nonvested at end of the period/year	<u>106,667</u>	1.13	<u>68,333</u>	4.91

At December 31, 2009, \$121 of unrecognized compensation cost related to nonvested stock options is expected to be recognized over a weighted average period of approximately 2 years.

8. Common and Preferred Stock

The Company has Class A and B common stock with the difference being that the Class B shares are non-voting. The Class B shares are convertible into Class A shares on a share-for-share basis.

The Series A Preferred Stock includes the following characteristics and are more thoroughly outlined in the Certificate of Incorporation of the Company:

- not allowed to vote on any matters except as required by law.
- entitled to receive dividends payable in cash quarterly at 12% per annum on the Liquidation Preference amount, as defined. If payment is not made in cash, the dividend shall be increased to 15% per annum and considered payable on the Quarterly Dividend Payment Date, as defined, by the automatic issuance of preferred stock based on the Liquidation Preference amount, as defined.
- entitled to be paid, prior to payment or distribution to any other stockholders, \$100 per share plus any accrued or accumulated but unpaid dividends, referred to as the Liquidation Preference amount, upon a liquidation event of the Company, as defined.

9. Income Taxes

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

	<u>12/31/09</u>	<u>1/31/09</u>
Provision (benefit) at federal statutory rate	(34.0)%	(34.0)%
Non-deductible items	6.56	1.7
Deferred tax valuation allowance	<u>27.44</u>	<u>32.3</u>
	<u>-</u>	<u>-</u>

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:

	<u>12/31/09</u>	<u>1/31/09</u>
Deferred tax assets:		
Bad debt	\$ 215	\$ 458
Inventory reserve	1,373	1,558
Amortization of tax goodwill	350	694
Net operating loss carryforwards	9,200	8,837
Other	<u>357</u>	<u>158</u>
	11,495	11,705
Valuation allowance	<u>(11,495)</u>	<u>(11,705)</u>
Net deferred income tax assets	<u>\$ -</u>	<u>\$ -</u>

9. Income Taxes (continued)

The Company has \$12,258 of deductible goodwill for income tax purposes at December 31, 2009.

The valuation allowance decreased by \$156 (100% allowance against deferred tax assets) for the eleven months ended December 31, 2009 and increased by \$2,463 for the year ended January 31, 2009 (100% allowance against deferred tax assets). The Company has net operating loss carryforwards totaling approximately \$24,590 for federal income tax purposes, and various state net operating loss carryforwards. The carryforwards expire between 2024 and 2030. The Company's ability to use the net operating loss carryforwards to offset any future taxable income can be subject to limitations attributable to equity transactions that resulted in a change of ownership as defined by Section 382 of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code ("IRC"). The Company believes that that it is more likely than not, which under accounting guidance for tax positions indicates a likelihood greater than 50%, the equity transactions described in Notes 3 and 5 do not result in IRC limitations on the net operating loss carryforwards.

The Company files income tax returns in the U.S and various U.S. states and various foreign jurisdictions. The Company's tax returns are subject to review by the authorities in these jurisdictions. The Company's U.S. federal tax return for the year ended January 31, 2008 is currently under examination by the Internal Revenue Service. There are currently no matters that the Company is aware of that would change its tax filings.

10. Employee Benefit 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% of their salary, with the Company partially matching employee contributions and covering certain administrative expenses of the savings plan. Effective February 1, 2009, the Company suspended matching contributions. Employees vest in the Company contribution ratably over three years. The Company expensed \$14 and \$118 related to the savings plan during the period ended December 31, 2009 and year ended January 31, 2009, respectively. Employees do not have an option to invest in the Company's stock under the savings plan.

11. Related Party Transactions

The Company and First Equity Development, Inc. ("First Equity") the wholly-owned subsidiary of First Equity Group, Inc., a controlling stockholder of the Company, have an agreement relating to the allocation of potential investment and acquisition opportunities in the aerospace parts distribution and logistics businesses. The agreement was approved by the independent members of the Board of Directors on a month-to-month basis effective February 1, 2004. First Equity Group, Inc. is beneficially owned by Mr. Aaron P. Hollander, President and Chief Executive Officer of the Company. Pursuant to the agreement, neither First Equity nor any of its majority-owned subsidiaries will consummate any acquisition of a majority interest in any aerospace parts distributions and logistics business anywhere in the world (a "Covered Acquisition"), without first notifying the Company and providing the Company with the opportunity to effect the Covered Acquisition for its

11. Related Party Transactions (continued)

own account. The Company's decision as to whether to effect the Covered Acquisition will be made by the independent members of the Board of Directors of the Company. The agreement can be terminated by either party upon 30 days written notice to the other party. The agreement does not apply to any proposed acquisition by First Equity of any business that generates less than 15% of its aggregate net sales from aerospace parts distribution or logistics, or to any advisory services performed by First Equity on behalf of third parties.

The Company subleases office space from First Equity in Westport, CT. The leased space is utilized by the Company as its corporate headquarters. First Equity also utilizes space in the same premises.

The sublease, which became effective April 21, 1997, was for an initial period of ten years with two subsequent five year renewal extensions, and was cancelable by either party with six months notice. First Equity renewed the lease March 24, 2010 with no termination date and the lease is cancelable by either party with six months notice. Lease payments under this sublease totaled approximately \$53 and \$51, for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively.

The Company and First Equity also share certain common expenses that arise from sharing office space in Westport, CT. The Company reimburses First Equity, and vice versa, for expenses each entity incurs related to the common usage of the office space. The amounts are included in the Company's corporate expenses, and include expenses such as telephone, computer consulting, office cleaning, office supplies and utilities. The expenses are allocated based upon a formula reviewed and approved by the independent directors of the Company. Management believes this method of allocation is reasonable. In addition, the amounts reimbursed by the Company are the actual costs incurred for the expense. The Company reimbursed First Equity, \$164 and \$31 for the eleven months ended December 31, 2009 and year ended January 31, 2009, respectively. Amounts owed to First Equity at December 31, 2009 and January 31, 2009 are \$4 and \$-0-, respectively.

In order to simplify the administration of payroll, certain employees of the Company who are authorized to perform services for both the Company and First Equity are paid through the payroll of First Equity. Employees of the Company who work exclusively for the Company by agreement are paid through the payroll of API.

12. Interest Expense and Other Income, Net

	<u>12/31/09</u>	<u>1/31/09</u>
Interest expense	\$ (1,123)	\$ (1,421)
Foreign exchange gain	36	41
Other income (expense)	<u>(39)</u>	<u>6</u>
	<u>\$ (1,126)</u>	<u>\$ (1,374)</u>

12. Interest Expense and Other Income, Net (continued)

The components primarily relate to interest expense on debt and foreign exchange transaction gain from Canadian functional currency (API Ltd.). Effective February 1, 2008 the Company's Board of Directors authorized that \$2,000 of intercompany debt from API Ltd. to API be considered as "long-term investment" and, as such, foreign exchange transaction adjustments are included in Other Comprehensive Income (reported in Stockholders' Equity).

13. Net Loss Per Share

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

	<u>12/31/09</u>	<u>1/31/09</u>
Denominator for basic net income (loss) per share – weighted average shares	8,250,906	7,465,583
Effect of dilutive employee stock options	<u>-</u>	<u>-</u>
Denominator for net income (loss) per share – assuming dilution – adjusted weighted average shares	<u>8,250,906</u>	<u>7,465,583</u>

Stock options (Note 7 – 181,650 at December 31, 2009 and 111,650 at January 31, 2009) are not considered in the loss per share computations as the effects would be anti-dilutive.

14. Commitments and Contingencies

Leases

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 leases also allow for cancellation of the lease upon payment of a penalty. 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 at December 31, 2009, are as follows:

2010	\$ 1,562
2011	1,290
2012	1,145
2013	768
2014	721
Thereafter	<u>1,501</u>
Total	<u>\$ 6,987</u>

Rental expense under noncancelable operating leases amounted to \$1,443 and \$1,515 for the eleven months ended December 31, 2009 and year ended January 31, 2009.

14. Commitments and Contingencies (continued)

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, cash flows 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, results of operations or cash flows. The Company maintains what it believes is adequate liability and other insurance to protect it from such claims.

First Aviation Services Inc.

Supplemental Schedule - Consolidated Statement of Operations (in thousands)

For the Twelve Months Ended December 31, 2009

Net sales	\$ 108,933
Cost of sales	<u>(90,004)</u>
Gross profit	18,929
Selling, general and administrative expenses	15,513
Corporate expenses	2,258
Acquisition expenses	<u>683</u>
Income from operations	475
Non-operating income (expense)	
Interest income	12
Interest expense and other, net	<u>(1,201)</u>
Net loss	<u><u>\$ (714)</u></u>

See auditors' disclaimer of opinion.