



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.

In Fiscal Year 2002, we were awarded significant logistics contracts. This cover signifies that First Aviation Services is ready for a new departure.

First Aviation Services Inc. (FAvS or the “Company”), together with its principal operating subsidiary, Aerospace Products International, Inc. (API), is one of the leading 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 component 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, governments and military services.

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**Aerospace Products International Headquarters,
Memphis, Tennessee**

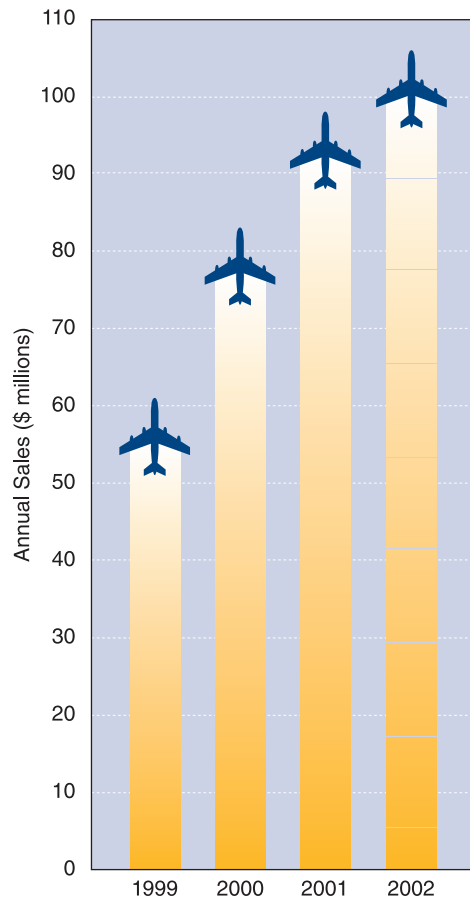


API Asia Pacific, Inc., located in the Philippines

TO OUR SHAREHOLDERS



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Our Fiscal Year 2002, ending January 31, 2002, was a difficult year for the United States and for the aviation industry. The airlines started to feel the effects of the recession in the first quarter. Reduced high yield business travel coupled with higher labor costs pushed the industry into a downturn. The horrific attacks of September 11th, while having a negative effect on the economy, sent the aviation and airline industry into what can only be described as a depression. The complete shutdown of commercial aviation in Canada and the United States was unprecedented. In the United States, airline revenues were off 30 percent in the months immediately following September. By the end of the fiscal year – in February 2002 – airline revenues continued to be off by more than 20 percent. Under these extraordinary circumstances, FAvS performed well.

Aerospace Products International (API) provides the aviation parts buyer the best value at the lowest possible cost. API's **single point distribution model** is critical to that positioning. The customer gets the best service as well as the highest parts availability, both at reasonable prices. API's technology and its business processes allowed it to move very quickly in adjusting its cost structure immediately following September 11th. Now, API will help the aviation business get back on its feet by eliminating indirect costs, by increasing direct labor productivity and by reducing working capital requirements.

Individuality, freedom, and innovation are key to the foundation of the United States. These qualities are helping the country adjust to a new environment. The industry is continuing to learn to be more flexible and to innovate – to do more with less. Outsourcing and globalization, therefore, are critical.

The terrorist attacks of September 11th hit the aviation industry harder than most industries. Higher costs and lower demand prevail. However, despite being grounded for a couple of months following September 11th, the general aviation sector is expected to recover relatively quickly. This is especially true in the corporate aviation sector. The downside for the airlines is that this rebound will come at the expense of their high yield business market.

The airline business is divided into two groups: the vertically integrated old model and the **agile new model**. The old model airlines, such as American, United and Delta, require revolutionary change in order to adapt to a price sensitive market, as well as the return requirements of financial stakeholders. These airlines generally maintain their own aircraft at high cost. They commonly describe labor as the reason for their lack of efficiency, which is true if they include back-office personnel, not just the people on the shop floor. These airlines spend between 40 and 50 cents of every revenue dollar on back-office activities; not on direct material, nor on direct labor. Improved business practices and support technology offer these airlines the greatest opportunity to reduce their cost structures, increase efficiency, and improve productivity. The people managing these airlines understand this and are working to right the situation.

The new model airlines, such as Southwest, Jet Blue and Canada's WestJet, operate simple organizations. These companies take advantage of the ability to outsource non-core tasks to focused organizations that provide better services at a lower cost. These business practices create value for the airlines. As a result, since September 11th these airlines have done quite well.

The survival of the old model airlines, as currently configured, is a big question mark. This business model now is constrained by lower revenues and higher expenses.

The call for “more for less” across industry and government is resulting in at least two trends: outsourcing and globalization. The two work in tandem to reduce costs.

At **First Aviation** we have a favored expression: “better is better.” It used to be that a company could offer the market a product with better attributes and demand a premium for that product. Today, the market demands products with the best attributes at the lowest possible price. This phenomenon is driving the trend to outsourcing and globalization. Successful companies cannot afford to perform tasks that are not core to their success. Everything else is being outsourced to suppliers whose focus it is to perform these tasks better than anybody else. Furthermore, those tasks that are being provided by the experts must be delivered at the lowest possible cost. The pressure to grow earnings in an environment of low revenue growth will continue to drive outsourcing and globalization as means to accomplish objectives.

Technology plays an essential role in enabling companies to outsource and globalize. While governments have outsourced some tasks in the past, the trend toward outsourcing government services will accelerate in a constrained environment. Imagine, even governments focusing on mandates and core competencies! API sees opportunities in the government markets.

Since its founding in 1995, First Aviation Services has been dedicated to offering the aviation market exceptional service at the lowest possible price. API was able to accomplish this on the basis of a business model that had not been tested by its competitors; single point distribution. The same philosophy that has driven API's

Gulfstream Aerospace Corporation awarded API a consulting mandate to study the efficiency of its aftermarket support business.





API is an important part of Piper's supply chain.

distribution strategy is now driving the Company's entry into the supply chain management market. **API is in the service business**, not the parts business. This focus and direction applies to both supply chain management and parts distribution. Every element of API's business is geared toward saving our customers money and helping create value. API continues to develop services and systems that reduce the back-office expenses and increase the efficiency of direct labor and working capital.

In reviewing Fiscal Year 2002, First Aviation's sales, before September 11th, continued to grow at double digit rates. Post September 11th, the Company's sales were essentially flat despite an 8% drop in the parts market. The Company's ability to grow underscores the decisions made several years ago to base API's distribution business on the single point model and to leverage the services and technology required to satisfy the needs of distribution customers into supply chain management.

The Company's two most significant accomplishments in Fiscal Year 2002 were: 1) quickly cutting costs and increasing efficiency; and 2) changing its business model from selling parts to **providing long-term, value-added services**.

FAvS reacted rapidly to the change in the marketplace as a result of the terrorist acts. This required a response that would scale the business to an unknown environment and for an uncertain amount of time. The team at API demonstrated excellent judgment and responded incredibly well. Tough decisions were made to keep the company healthy. Many in the industry were not as fortunate to have such a great team or as strong a balance sheet.

While it is difficult to see a positive outcome from the devastating impact on our country caused by the events

of September 11th, it has certainly sharpened the focus of OEMs, airlines, suppliers, and others to be responsive to changes in the marketplace. The interest in **supply chain management solutions** is much greater today than it was twelve months ago. The desire to be adaptable, low cost, and provide a higher level of service, especially when traditional systems are impaired, has driven more companies to look for better solutions. FAVS will be a beneficiary of these important developments.

API accomplished three big breakthroughs in the supply chain management business in Fiscal Year 2002: (1) Federal Express renewed its contracts for oils, lubricants, and shelf-life items with the Company; (2) API was chosen by Superior Air Parts to be Superior's exclusive third party logistics provider for the distribution of all its engines and engine parts; and (3) API was chosen by General Dynamics Aviation Services, which includes Gulfstream Aerospace, to recommend improvements to the company's after-market support functions – specifically, its information technology and its inventory management.

As these significant advances developed in the Company's supply chain management business, the Company was reorganized into two business divisions: **distribution and logistics**. This reorganization will increase our service levels and will give our managers an opportunity to better develop their businesses, allowing their success to be directly linked to their performance.

First Aviation Services is stronger now than it has ever been. In Fiscal Year 2002, our Company has evolved. The Company operates a business model that is appropriate for the changes taking place in the aviation industry. We are very hopeful that the Company's stock will soon reflect the value that is created on a day-to-day basis.

While the Company dealt with the tragedies of September 11th, we also dealt with the very sad loss of an outstanding individual, Mr. Charles Ryan. Charlie was a member of the Board of Directors of First Aviation Services since our initial public offering in 1997. He was instrumental in encouraging the Company to change its business model away from the industry's status quo. We thank Charlie for his insight and wish that he could see that his vision is coming to reality. We also wish his family and his business partners at Nordam great satisfaction in bringing his ideas to fruition.

The Company has an **excellent Board of Directors**. Outside directors include Robert Kirk, Stanley Hill, and Joseph Lhota – a tremendous recent addition. Joe worked in Mayor Giuliani's administration as Deputy Mayor. Each board member brings unique skills to First Aviation. We thank them for their dedication to the Company.

It's been a year of immense change. The Company is ready to face the future. We thank our customers, our suppliers and our employees for their dedication and perseverance.

Very truly yours,



Michael C. Culver



Aaron P. Hollander



FAVS strategy is built on leveraging state-of-the-art technology, single point infrastructure and great people.

REVIEW OF OPERATIONS OF API



Aerospace Products International (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 provide its customers' customers 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 operates under two business divisions: distribution and logistics. While distribution and logistics are both elements of supply chain management, the Company segmented the two based on the following differences: economics, selling cycles, transaction size and where in the customers' organization the purchase decision takes place. Profitability in the distribution business is driven by margin on parts sales whereas profitability in the logistics business is driven by long-term, fee-based service contracts.

While there are very distinct differences between distribution and other supply chain management services, the two businesses use, fundamentally, the same technology and systems platforms.

API's Distribution Division, based on its single point distribution and logistics model, offers the aerospace aftermarket the most effective parts distribution system in the industry. Availability, 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 not only superior parts availability, but also a service level that is very difficult to match with the distributed branch system used by API's competitors. 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.

Our model provides API's 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 Division (API Logistics) is responsible for all activities that relate to supply chain management. The Company formalized this division in the fourth quarter of Fiscal Year 2002. While API has been developing its supply chain management services for the last three years, the increased focus of a dedicated logistics business unit 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 Logistics is responsible for order intake, pick-pack-and-ship, reverse logistics, tier one technical support and invoicing; and a consulting contract for General Dynamics for its aviation services after-market support business. While each contract is unique, API

Logistics 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. Services offered by API Logistics include shelf life management, systems integration, reversed 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.

API Logistics is totally dedicated to taking process costs and working capital out of the aviation supply chain. Airlines spend an estimated 40 to 50 cents of every maintenance dollar on administrative and overhead costs – not parts, nor direct labor. U.S. airlines spend approximately \$35 to \$40 billion on maintenance; 50 percent of this number represents an enormous opportunity to bring efficiency to and increase the 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. It's 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 where 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 value proposition strong enough to support the creation of barriers to entry. First Aviation has decided that "pay-to-play" is not the highest and best use of its capital nor does it optimize the cost of capital among industry players. The strategy does not play to the Company's skill set. API spends its capital on developing proprietary systems that create long-term defensible service offerings rather than tying up dollars in working capital.

Customers have told us that they chose API because it has excellent systems. API's systems are a combination of suitable and robust technology, human creativity, and a sustainable business model. The three elements all must fit together.

API will continue to pursue growth in both traditional parts distribution and supply chain management services. While the trends in the distribution market portend low growth, one of the keys to success is scale and API is examining all logical acquisition candidates in traditional distribution. The acquisition of the Superior Air Parts distribution business underscores this strategy. At the same time, API is approaching acquisition targets which 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. API's Logistics Division will experience rapid evolution in the continuing development of its business in Fiscal Year 2003.



API has made significant inroads supplying parts to the regional airline market.



CONSOLIDATED FINANCIAL STATEMENTS



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, 2002 and 2001, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2002. 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, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2002, in conformity with accounting principles generally accepted in the United States.

Stamford, Connecticut
April 12, 2002

Ernst & Young LLP

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CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	January 31,	
	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	\$ 31,113	\$ 31,855
Trade receivables, net	15,396	15,860
Inventories, net	23,016	21,803
Deferred and refundable income taxes	1,212	3,388
Prepaid expenses and other	1,822	1,461
Total current assets	<u>72,559</u>	<u>74,367</u>
Plant and equipment, net	4,100	4,638
Goodwill and other intangibles, net	3,885	1,709
	<u>\$ 80,544</u>	<u>\$ 80,714</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 11,464	\$ 13,496
Accrued compensation and related expenses	1,195	1,111
Other accrued liabilities	1,553	3,210
Income taxes payable	1,293	2,120
Current debt and obligations under capital leases	180	11,757
Total current liabilities	<u>15,685</u>	<u>31,694</u>
Long-term debt and obligations under capital leases	14,800	147
Minority interest in subsidiary	1,041	1,041
Total liabilities	<u>31,526</u>	<u>32,882</u>
Stockholders' equity		
Common stock, \$0.01 par value, 25,000,000 shares authorized, 7,213,753 and 7,184,704 shares outstanding, respectively	91	91
Additional paid-in capital	38,516	38,625
Retained earnings	20,728	19,476
Accumulated other comprehensive loss	(193)	-
	<u>59,142</u>	<u>58,192</u>
Less: Treasury stock, at cost	<u>(10,124)</u>	<u>(10,360)</u>
Total stockholders' equity	<u>49,018</u>	<u>47,832</u>
Total liabilities and stockholders' equity	<u>\$ 80,544</u>	<u>\$ 80,714</u>

See accompanying notes.

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Year ended January 31,		
	2002	2001	2000
Net sales	\$ 105,696	\$ 97,550	\$ 82,999
Cost of sales	83,722	76,682	65,015
Gross profit	21,974	20,868	17,984
Selling, general and administrative expenses	19,854	19,733	16,014
Corporate expenses	2,628	2,934	1,652
Litigation (income) expense	(735)	501	–
Non-recurring charge	–	–	410
Income (loss) from operations	227	(2,300)	(92)
Interest income	592	1,955	723
Interest expense and other	(291)	(538)	(612)
Minority interest in subsidiary	(42)	(42)	(42)
Income (loss) before for income taxes	486	(925)	(23)
(Provision) benefit for income taxes	(194)	349	190
Income (loss) from continuing operations	292	(576)	167
Income (loss) from discontinued operations, net	–	(1,847)	5,170
Gain from disposition of subsidiaries, net	960	593	10,193
Net income (loss)	\$ 1,252	\$ (1,830)	\$ 15,530
<i>Basic net income (loss) per common share:</i>			
Income (loss) from continuing operations	\$ 0.04	\$ (0.08)	\$ 0.02
Income (loss) from discontinued operations, net	–	(0.24)	0.58
Gain from disposition of subsidiaries, net	0.13	0.08	1.14
Basic net income (loss) per common share	\$ 0.17	\$ (0.24)	\$ 1.74
Weighted average common shares outstanding – basic	7,197,941	7,720,520	8,908,756
<i>Net income (loss) per common share – assuming dilution:</i>			
Income (loss) from continuing operations	\$ 0.04	\$ (0.08)	\$ 0.02
Income (loss) from discontinued operations, net	–	(0.24)	0.57
Gain from disposition of subsidiaries, net	0.13	0.08	1.13
Net income (loss) per common share – assuming dilution	\$ 0.17	\$ (0.24)	\$ 1.72
Weighted average common shares outstanding – assuming dilution	7,208,725	7,720,520	9,005,677

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	Subtotal	Treasury Stock	Total
	Number of Shares	Amount						
Balances at January 31, 1999	9,001,896	\$ 90	\$ 38,515	\$ 5,776	\$ -	\$ 44,381	\$ -	\$ 44,381
Exercise of stock options to purchase common shares	110,000	1	-	-	-	1	-	1
Shares issued under qualified plans and to directors	22,101	-	100	-	-	100	-	100
Common shares repurchased	(1,000,000)	-	-	-	-	-	(5,869)	(5,869)
Net income	-	-	-	15,530	-	15,530	-	15,530
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

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	Year ended January 31,		
	2002	2001	2000
Cash flows from operating activities			
Income (loss) from continuing operations	\$ 292	\$ (576)	\$ 167
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,399	1,251	846
Deferred income taxes	-	(148)	1,354
Stock compensation	112	72	50
Changes in assets and liabilities:			
Trade receivables	467	(2,050)	(4,251)
Inventories	1,708	(7,661)	(1,941)
Other assets	(73)	(1,662)	210
Accounts payable	(2,032)	5,232	3,990
Other accrued liabilities	-	(7,812)	2,233
Cash provided by (used in) operating activities – continuing operations	1,873	(13,354)	2,658
Cash provided by (used in) operating activities – discontinued operations	-	(730)	218
Net cash provided by (used in) operating activities	1,873	(14,084)	2,876
Cash flows from investing activities			
Purchases of assets from Superior, including acquisition costs	(5,028)	-	-
Proceeds from sale of NAC	-	-	73,000
Purchases of plant and equipment and other assets – continuing operations	(683)	(1,529)	(1,592)
Purchases of plant and equipment – discontinued operations	-	(1,494)	(3,530)
Net cash provided by (used in) investing activities	(5,711)	(3,023)	67,878

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(IN THOUSANDS)

	2002	Year ended January 31, 2001	2000
Cash flows from financing activities			
Net borrowings (repayments) on debt and capital lease obligations	\$ 3,076	\$ 3,411	\$ (14,981)
Repurchases of common stock for treasury	(5)	(4,834)	(5,869)
Other	25	281	51
	<u>3,096</u>	<u>(1,142)</u>	<u>(20,799)</u>
Net cash provided by (used in) financing activities			
	<u>3,096</u>	<u>(1,142)</u>	<u>(20,799)</u>
Net change in cash and cash equivalents	\$ (742)	\$ (18,249)	\$ 49,955
Cash and cash equivalents at the beginning of the year	31,855	50,104	149
	<u>31,113</u>	<u>31,855</u>	<u>50,104</u>
Cash and cash equivalents at the end of the year			
	<u>31,113</u>	<u>31,855</u>	<u>50,104</u>
Supplemental cash flow disclosures			
Cash paid for:			
Interest	\$ 130	\$ 455	\$ 575
Income taxes (refunded) paid, net	\$ (748)	\$ 4,196	\$ 90
Acquisition of equipment through incurrence of capital lease obligation	\$ -	\$ 315	-

See accompanying notes.

NOTES TO 2002 CONSOLIDATED FINANCIAL STATEMENTS

(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 Ltd."), API Asia Pacific Inc., ("API Asia Pacific"), and its majority-owned subsidiary, Aerospace Products International, Inc. ("API"), (collectively the "Company"), is one of the leading 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. 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 4, on August 10, 2001 the Company acquired the distribution business of Superior Air Parts, Inc. ("Superior"). As described in Note 10, in prior years the Company sold NAC, and, during the last quarter of the prior fiscal year, the Company approved a plan to dispose 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.

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.

Net Sales and Trade Receivables

The Company's net sales consist of sales of parts and components, the provision of component overhaul and repair services, and the provision of supply chain management services. Sales are recorded net of discounts, allowances and commissions, and are recorded generally when the parts, components, and overhauled and repaired items are shipped and title to the parts transfers to the customer, or when supply chain management services have been provided.

Sales to unaffiliated foreign customers were approximately 17%, 13% and 9% of net sales for the years ended January 31, 2002, 2001 and 2000, 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. The allowance for doubtful accounts was \$707 and \$947, respectively, at January 31, 2002 and 2001.

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 a part of selling, general and administrative expenses. The costs of shipping and handling included in selling, general and administrative expenses was \$3,937, \$3,729 and \$3,129 for the years ended January 31, 2002, 2001 and 2000, respectively.

Stock Based Compensation

The Company recognizes compensation expense on stock option grants to employees to the extent a difference exists between the exercise price of the stock option and the fair market value per share at the date of grant. No compensation expense was recognized during the years ending January 31, 2002, 2001 and 2000 since all grants were issued at the fair market value of the Company's common stock at the date of grant. The Company also recognizes expense on common stock issued to its directors as compensation. The amount of shares issued is based upon the fair market value per share at the date issued.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits, money market funds, short-term certificates of deposit, and short-term commercial paper with maturities of three months or less when purchased.

Inventories

Inventories generally consist of aircraft parts and components and are stated at the lower of cost or market, with cost determined using the first-in, first-out method. Provisions are made in each period for the estimated effect of excess and obsolete and slow moving inventories. Actual excess and 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 \$885 and \$376, respectively, at January 31, 2002 and 2001.

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 ranges 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.

Goodwill and Other Intangibles

The excess of the purchase price of API over the fair value of the net assets acquired is amortized using the straight-line method over a thirty-year period. Accumulated amortization was \$322 and \$257, at January 31, 2002 and 2001, respectively. The net goodwill associated with the acquisition of API was \$1,643 at January 31, 2002. The remaining balance relates to the acquisition of Superior.

Long-Lived Assets

The Company records impairment losses on long-lived assets when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. No asset impairments relating to continuing operations were recorded during the years ended January 31, 2002, 2001 and 2000.

Principal Suppliers

API has five suppliers of parts, components and supplies from whom approximately 53%, 49% and 45% of its total purchases were made during the years ended January 31, 2002, 2001 and 2000, respectively. Accounts payable to these vendors totaled \$3,956 and \$5,140 at January 31, 2002 and January 31, 2001, 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.

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. In prior years the amount of the translation was not significant. The increase during the year ended January 31, 2002 was due to a decrease in the value of the Canadian dollar relative to the US dollar. Comprehensive income for the year ended January 31, 2002 was \$1,059.

Reclassifications

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

3 Plant and Equipment

Plant and equipment consist of the following:

	January 31,	
	2002	2001
Machinery and equipment	\$ 1,183	\$ 1,502
Buildings and leasehold improvements	1,759	1,033
Computer equipment, software, office furniture, fixtures and other office equipment	5,276	4,802
Construction-in-process	36	53
	<u>8,254</u>	<u>7,390</u>
Less: accumulated depreciation	<u>(4,154)</u>	<u>(2,752)</u>
	<u>\$ 4,100</u>	<u>\$ 4,638</u>

Certain equipment has been pledged as collateral under capital leases.

4 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 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 and other intangibles in the accompanying consolidated balance sheets. 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. The accruals remaining at January 31, 2002 will be utilized in the next fiscal year.

The distribution agreement has a five-year term, and is renewable, at the Company's option, for two additional three-year terms. Thereafter, the agreement automatically renews unless notice is given by one party to the other of its intention not to renew.

The Company also entered into a service agreement with Superior. Pursuant to the terms of this agreement, the Company provides Superior with a variety of third party logistics services for a fee based upon the scope of the services provided. The service agreement has an initial five-year term, and is renewable thereafter for two additional three-year terms at the Company's option. Thereafter, the agreement automatically renews annually unless notice is given by one party to the other of its intention not to renew.

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

5 Current and Long-Term Debt and Obligations Under Capital Leases

	January 31,	
	2002	2001
Current		
Revolving line of credit	\$ -	\$ 11,500
Current portion of obligations under capital leases	<u>180</u>	<u>257</u>
	<u>\$ 180</u>	<u>\$ 11,757</u>
Long Term		
Revolving line of credit	\$ 14,800	\$ -
Obligations under capital leases	<u>-</u>	<u>147</u>
	<u>\$ 14,800</u>	<u>\$ 147</u>

In June 2001, API entered into an extension of its \$20,000 commercial revolving loan and security agreement with a bank. Borrowings under this credit 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 credit agreement 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. The credit agreement also requires API to maintain minimum levels of net worth and specified interest expense coverage ratios, and restricts the payment of dividends on API's common stock. Substantially all of API's domestic assets are pledged as collateral under this credit facility, and First Aviation guarantees all borrowings under the facility. The Agreement expires July 1, 2003 whereupon amounts due under the facility will be payable. This agreement replaced a prior agreement that contained substantially the same terms and conditions. Fees on the unused line have not been significant. Borrowings under the facility totaled \$14,800 at January 31, 2002 at an interest rate

of 3.36%. The Company had approximately \$3.5 million of unused availability under the facility at January 31, 2002.

Management believes that the carrying amount of the Company's borrowings approximates fair market 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. Obligations due more than one year from the balance sheet date are classified as long term. Interest expense on the obligations is recorded as incurred.

6 Stockholders' Equity

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.

Certain of the Company's directors elected to receive their compensation for the years ended January 31, 2002, 2001 and 2000 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 increase to treasury stock and additional paid-in capital. Such compensation expense totaled \$112, \$72 and \$50, for the years ended January 31, 2002, 2001 and 2000, respectively.

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. For the years ended January 31, 2002 and 2001, the Company issued 4,697 and 8,690 shares to employees under the ESPP, respectively. At January 31, 2002, 192,768 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 and stock purchase rights. A total of 1,000,000 shares of common stock have been reserved for issuance under the Plan. Only stock options have been issued under the Plan. All of the stock options vest over two- to four-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, 2002, 2001 and 2000 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, 2002, options for 536,000 shares had been issued, leaving 464,000 shares available under the Plan. The following table is a summary of activity related to stock options for the respective year ended January 31:

	2002		2001		2000	
	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	375,500	\$ 6.16	252,500	\$ 7.05	361,950	\$ 5.96
Granted	195,500	4.36	180,500	5.08	102,500	4.50
Exercised	-	-	-	-	(110,000)	0.01
Forfeited	(185,000)	5.90	(57,500)	6.72	(101,950)	8.21
Outstanding at end of year	386,000	\$ 5.37	375,500	\$ 6.16	252,500	\$ 7.05
Exercisable at end of year	155,249	\$ 6.57	132,000	\$ 7.94	93,000	\$ 9.22

The following table is a summary of information about stock options outstanding at January 31, 2002:

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	137,500	9.2 years	\$ 4.31	-	N/A
4.50 - 6.00	198,500	7.8 years	4.96	105,249	\$ 4.95
10.00	50,000	5.4 years	10.00	50,000	10.00
\$ 4.31 - \$ 10.00	386,000	8.0 years	\$ 5.37	155,249	\$ 6.57

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 valuation 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 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.

NOTES TO 2002 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

	2002	2001	2000
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	4.0%	5.0%	5.15%
Expected volatility	41.9%	49.3%	39.8%
Expected life of option	4.0 years	4.0 years	4.0 years
Weighted-average fair value of options granted during the year	\$ 1.64	\$ 2.24	\$ 1.81

Using the above noted assumptions and the weighted average fair value of each option granted during the years ended January 31, 2002, 2001 and 2000, respectively, the pre-tax additional pro forma compensation expense that would have been recorded was approximately \$317, \$247 and \$155, or \$0.04, \$0.03 and \$0.02 per share, respectively.

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, 2002, 2001 and 2000, 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.

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, and commencing three years after the closing of the API acquisition, AMR Combs has the right to cause the Company to repurchase the Preferred Stock. The Company has the ability to delay this right, under certain conditions, for an additional two years. 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,		
	2002	2001	2000
Current:			
Federal	\$ 236	\$ (201)	\$ 236
State	(42)	—	30
	194	(201)	266
Deferred:			
Federal	\$ —	\$ (191)	\$ (370)
State	—	43	(86)
	—	(148)	(456)
Total provision (benefit)	\$ 194	\$ (349)	\$ (190)

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,		
	2002	2001	2000
Provision (benefit) at federal statutory rate	34.0%	(34.0)%	(34.0)%
State tax provision (benefit), net of federal	(7.9)	3.1	(161.0)
Change in valuation allowance	—	—	(1,065.0)
Foreign losses with no income tax benefit	—	—	385.0
Non-deductible items and other	13.8	(6.8)	48.9
	39.9%	(37.7)%	(826.1)%

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,	
	2002	2001
Financial statement accruals not currently deductible for income tax purposes, and net operating loss carry forwards	\$ 1,264	\$ 2,080
	<u>1,264</u>	<u>2,080</u>
Valuation allowance	-	-
Net deferred income tax assets	<u>\$ 1,264</u>	<u>\$ 2,080</u>

Based upon a number of factors, including the nature of the temporary differences and the timing of their reversal, the Company believes that the utilization of the deferred tax benefit at January 31, 2002 and 2001 was more likely than not; therefore, a valuation reserve was not provided. The decrease in the deferred tax asset is due principally to the utilization of the benefit by the discontinued operations. At January 31, 2002 the Company had a net operating loss carry-forward of approximately \$1,200 for federal income tax purposes. The carryforward expires in 2022.

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 \$171, \$143 and \$102 related to the savings plan in the years ended January 31, 2002, 2001 and 2000, respectively. Employees do not have an option to invest in the Company's stock under the savings plan.

9 Related Parties

Upon the authorization of the independent members of the Board of Directors, the Company entered into an advisory agreement with a related party, First Equity Development Inc. ("First Equity"). The advisory agreement, which was effective February 1, 2000, had a two-year term. Pursuant to the terms of this agreement, First Equity provided the Company with investment and financial advisory services relating to potential acquisitions and other financial transactions. The Company paid First Equity a \$30 monthly retainer. In addition, upon the successful completion of certain transactions, the Company would pay a fee to First Equity (the "Success Fee"), and would reimburse First Equity for its out-of-pocket expenses. The amount of any Success Fee would be established by the independent members of the Board of Directors and would be

dependent upon a variety of factors, including, but not limited to, the services to be provided and the size and 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 the year ended January 31, 2002 the Company paid First Equity retainer fees of \$340. (First Equity voluntarily reduced the amount of the retainer fees due over the four months ended January 31, 2002.) During each of the years ended January 31, 2001 and 2000, the Company paid First Equity retainer fees of \$360, for an aggregate total over the three years of \$1,060. Upon the consummation of the sale of NAC (Note 10), the Company paid First Equity a Success Fee of \$945. The Success Fee was net of \$360 of retainer fees previously paid and expensed by the Company. The gross amount of the fee was charged against gain from dispositions of subsidiaries, net, while the amount previously expensed was credited against corporate expenses in the fourth quarter of the year ended January 31, 2000. The agreement could be terminated by either party upon 30-days written notice to the other party. Effective February 1, 2002 the Company renewed the advisory agreement with First Equity for two years under substantially the same terms and conditions.

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 \$91, \$95 and \$102, for the years ended January 31, 2002, 2001 and 2000, respectively.

In addition, the Company paid an affiliate of First Equity approximately \$84 for printing and mailing services.

10 Discontinued Operations

Details of the results of discontinued operations and net gain from dispositions of subsidiaries are as follows:

	Year ended January 31,		
	2002	2001	2000
Income (loss) from discontinued operations, net:			
AeroV	\$ -	\$ (1,847)	\$ -
NAC	-	-	5,170
	<u>\$ -</u>	<u>\$ (1,847)</u>	<u>\$ 5,170</u>
Gain from dispositions of subsidiaries, net:			
AeroV	\$ 191	\$ (386)	\$ -
NAC	769	979	10,193
	<u>\$ 960</u>	<u>\$ 593</u>	<u>\$ 10,193</u>

E-Commerce Initiative

In February 2000 the Company established AeroV Inc. ("AeroV"). The purpose of AeroV was to design a proprietary electronic procurement platform to enable easy 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 of AeroV. The Company took a pre-tax charge of \$1,245 during the three months ended January 31, 2001 to write-off its investment in AeroV. AeroV had no significant sales during the year ended January 31, 2001. The net loss of \$1,847 from the operations of AeroV for the year ended January 31, 2001, which included the asset impairment charge, was net of a benefit for income taxes of \$1,100. 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.

In connection with the disposition of AeroV, the Company accrued for certain costs directly relating to the disposition. Transaction, legal and other costs relating to the disposition (\$660) were included in other accrued liabilities at January 31, 2001 in the accompanying consolidated balance sheets. 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, was included in gain from dispositions of subsidiaries. At January 31, 2002, \$56 of the accruals remained. The accrual remaining at January 31, 2002 will be utilized in the next fiscal year.

Sale of NAC

On November 1, 1999, the Company consummated the sale of the stock of NAC to Rolls-Royce North America, Inc. 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"). NAC's operations included the repair and overhaul of gas turbine engines and accessories, and the remanufacturing of engine components and accessories. NAC has been accounted for as a discontinued operation for all years presented in the accompanying consolidated financial statements and its results of operations and cash flows through the date of sale, and the net gain on the sale have been reported separately.

Pursuant to the Agreement, Rolls-Royce North America, Inc. ("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 liquidation of its former defined benefit plan. During the year ended January 31, 2001, the sales price was adjusted down by \$2,050 to reflect a decrease in the amount of net assets sold. The amount paid had been accrued previously.

Summarized results of operations information for NAC are as follows.

	Nine months ended October 31, 2000
Net sales	\$ 85,400
Earnings before interest and taxes	7,458
Net interest expense	<u>1,251</u>
Earnings before income taxes	6,207
Provision for income taxes	<u>(1,037)</u>
Net income	<u><u>\$ 5,170</u></u>

As a result of the sale, the Company recorded a gain on disposition during the year ended January 31, 2000 of \$10,193, net of estimated income taxes of \$5,829. In addition, included in the net gain on disposition the Company accrued for estimated costs relating to the sale. Transaction costs and other costs directly relating to the sale, approximately \$3.7 million, excluding the estimated sales price adjustment and liabilities under NAC's liquidated pension plan (see below), were charged against gain from dispositions of subsidiaries.

On July 28, 1997, the Company replaced NAC's qualified defined benefit retirement plan (the "NAC Plan") with a defined contribution savings plan, qualified under Section 401(k) of the Internal Revenue Code. The Company previously had purchased guaranteed annuities for all retirees who were receiving benefits under the NAC Plan and provided for distributions in cash or rollovers to an IRA or other qualified retirement plan for all other participants in the NAC Plan. The Company used an outside consulting firm for assistance in calculating the amount of benefits or distributions due, and in liquidating the NAC Plan. The Company believed that the NAC Plan was liquidated according to regulatory guidelines.

In 1998, the Pension Benefit Guarantee Corporation ("PBGC") audited the liquidation of the NAC Plan. The PBGC disagreed with certain of the assumptions used by the consultants in calculating benefits due to the participants. As a result, the PBGC assessed NAC approximately \$500, excluding interest. In June 1999, the PBGC rejected the NAC's appeal and confirmed its finding. NAC also was liable for interest on the assessment, which the Company estimated to be approximately \$100. Accordingly, the Company previously accrued \$600 pre-tax during the year ended January 31, 2000 to cover the liability related to this matter. The charge previously was classified against gain from dispositions of subsidiaries.

Pursuant to the Agreement but prior to the amendment described below, First Aviation had been liable, subject to certain limitations, for any losses incurred by NAC related to environmental matters. NAC was liable for the initial \$1 million of such losses (the "Environmental Threshold"). Any losses above the Environmental Threshold would have been shared, with First Aviation assuming 80% of the losses. First Aviation's maximum liability for such losses could not

exceed \$5 million in the aggregate. First Aviation had liability for only those claims for losses where notice of the claim was submitted on or prior to the third anniversary of the closing date.

First Aviation also had been liable, subject to certain limitations, for certain non-income tax and non-environmental related losses (as specified in the Agreement) that may have been incurred by NAC subsequent to the sale. NAC was liable for the initial \$1 million of such losses (the "Basic Threshold"). Any losses above the Basic Threshold would have been borne by First Aviation. First Aviation's maximum liability for such losses could not exceed \$5 million in the aggregate. First Aviation had no liability for any claims for losses not submitted prior to March 1, 2001.

With respect to income taxes, First Aviation had been liable, without limitation, for any and all income taxes that may be imposed upon NAC for all taxable periods ending on or prior to the closing date.

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 all rights and responsibilities, including legal fees and other costs from the settlement date forward, relating to litigation previously initiated by the Company and NAC against Oracle Corporation and Avanti Systems, Inc., relating to a copyright infringement suit, and any exposure from the liquidation of NAC's former defined benefit 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 difference between the estimated income tax liabilities and the actual income tax liabilities reported, a gain of \$979, was included in gain from dispositions of subsidiaries for the year ended January 31, 2001. During the years ended January 31, 2002 and 2001, \$245 and \$2,469 was charged against the accruals, principally for compensation and legal expenses. During the year ended January 31, 2002, the Company reversed \$1,241 of accruals that no longer were needed. The net credit, after applicable income taxes of \$472, was included in gain on dispositions of subsidiaries. At January 31, 2002 and 2001, respectively, \$57 and \$1,549 of accruals remained relating to the sale of NAC. The accrual remaining at January 31, 2002 will be utilized in the next fiscal year.

11 Net Income (Loss) per Common Share

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

	Year ended January 31,		
	2002	2001	2000
Denominator for basic net income (loss) per common share – weighted average shares	7,197,941	7,720,520	8,908,756
Effect of dilutive warrants and employee stock options	10,784	–	96,921
Denominator for net income (loss) per common share – assuming dilution – adjusted weighted average shares and assumed conversions	7,208,725	7,720,520	9,005,677

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

12 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, 2002 are as follows:

Year ending January 31, 2003	\$ 778
Year ending January 31, 2004	586
Year ending January 31, 2005	564
Year ending January 31, 2006	564
Year ending January 31, 2007	592
Thereafter	2,965
	<u>\$ 6,049</u>

NOTES TO 2002 CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Future minimum rental payments for the year ended January 31, 2003 are net of sublease income of \$140. Rental expense under noncancelable operating leases amounted to \$918, \$830, and \$515 for the years ended January 31, 2002, 2001 and 2000, respectively.

Contingencies

On December 17, 2001, the Company announced that it had settled litigation previously initiated against Gulf Insurance Company for a cash payment to the Company of \$950. The income was recorded during the three months ended January 31, 2002.

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 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.

13 Quarterly Financial Information (unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended January 31, 2002				
Net sales	\$25,571	\$27,564	\$26,953	\$25,608
Gross profit	5,209	5,689	5,662	5,414
Income (loss) from				
continuing operations	87	70	(490)	625
Net income (loss)	87	777	(490)	878
Basic income (loss) per share				
from continuing operations	\$ 0.01	\$ 0.01	\$ (0.07)	\$ 0.09
Basic net income (loss)				
per common share	<u>\$ 0.01</u>	<u>\$ 0.11</u>	<u>\$ (0.07)</u>	<u>\$ 0.12</u>
Income (loss) per share from				
continuing operations –				
assuming dilution	\$ 0.01	\$ 0.01	\$ (0.07)	\$ 0.09
Net income (loss) per				
common share –				
assuming dilution	<u>\$ 0.01</u>	<u>\$ 0.11</u>	<u>\$ (0.07)</u>	<u>\$ 0.12</u>
Year ended January 31, 2001				
Net sales	\$22,335	\$24,039	\$26,221	\$24,955
Gross profit	4,760	5,354	5,606	5,148
Income (loss) from				
continuing operations	13	(71)	(29)	(489)
Net income (loss)	(116)	(362)	613	(1,965)
Basic loss per share from				
continuing operations	\$ –	\$ (0.01)	\$ –	\$ (0.07)
Basic net income (loss) per				
common share	<u>\$ (0.01)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>	<u>\$ (0.26)</u>
Loss per share from				
continuing operations –				
assuming dilution	\$ –	\$ (0.01)	\$ –	\$ (0.07)
Net income (loss) per				
common share –				
assuming dilution	<u>\$ (0.01)</u>	<u>\$ (0.04)</u>	<u>\$ 0.08</u>	<u>\$ (0.26)</u>

14 New Accounting Pronouncement (unaudited)

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations" ("FAS 141"), effective for all business combinations initiated after June 30, 2001, and No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), effective for fiscal years beginning after December 15, 2001. There was no financial impact to the Company upon the adoption of FAS 141 on July 1, 2001.

The Company will adopt FAS 142 as of February 1, 2002, the beginning of its new fiscal year. Under the new rules, goodwill and certain intangible assets no longer will be amortized but will be subject to annual impairment tests in accordance with the pronouncement. Other intangible assets will continue to be amortized over their useful lives. Application of the non-amortization provisions of FAS 142 will not have a significant impact on the Company's results of operations. Upon adoption of FAS 142 the Company is required to perform impairment tests relating to its goodwill and other intangibles existing at the date of adoption. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company. However, the impairment tests under FAS 142 are much different and more rigorous than those previously required under generally accepted accounting principles, especially when the book value of a company is in excess of its market value, which is the case for the Company. The Company believes that there is no impairment of value, and that the principle reason for the lower market value of the Company is due to the illiquidity of the Company's stock, which depresses the value of each share. Under the more stringent requirements of FAS 142, however, the Company may be required to take a non-cash charge to write-off or write down its goodwill and other intangibles. This charge would occur in the first quarter ending April 30, 2002. Total goodwill and other intangibles at January 31, 2002 was \$3,885. The amount of the non-cash charge could be as much as the total amount of the asset, or approximately \$0.32 per share after applicable income taxes. Any such charge would be accounted for as a cumulative effect of a change in accounting principle during the quarter ended April 30, 2002, and would not affect continuing operations or operating income.

SHAREHOLDER INFORMATION

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.firstaviation.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 upon request to our
headquarters, or may be found on our
website (www.firstaviation.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.

Analyst Coverage

John V. Pincavage
Pincavage & Associates, LLC
Westport, CT 06880

Board of Directors

Aaron P. Hollander^{2,3}
Chairman of the Board
First Aviation Services Inc.

*Michael C. Culver*³
President and
Chief Executive Officer
First Aviation Services Inc.

*Stanley J. Hill*¹
Retired President and
Chief Executive Officer
Kaiser Aerospace and Electronics

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Retired Chairman of the Board
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*Joseph J. Lhota*¹
Executive Vice President,
Corporate Administration
Cablevision Systems Corporation

John A. Marsalisi
Former Chief Financial Officer
First Aviation Services Inc.

Principle Officers

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President,
Chief Executive Officer and
Chief Operating Officer,
First Aviation Services Inc.

Gerald E. Schesinger
Senior Vice President,
First Aviation Services Inc.
President and Chief Executive Officer,
API

Michael D. Davidson
Chief Financial Officer and
Corporate Secretary
First Aviation Services Inc.

¹ Member of Audit Committee

² Member of Compensation Committee

³ Member of Executive Committee



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.firstaviation.com

For opportunities with API please visit the website at 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.

Safe Harbor Statement Under the Private Securities Litigation Reform Act 1995

Information included in this Annual Report may contain 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. In evaluating such statements as well as the future prospects of the Company, specific consideration should be given to various factors, including the Company's ability to obtain parts from its principal suppliers on a timely basis, 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, the Company's relationships with its customers, the ability to obtain and service supply chain management contracts, the ability to consummate suitable acquisitions and other items that are beyond the Company's control and may cause actual results to differ from management's expectations. In addition, specific consideration should be given to the various factors discussed 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

Websites: www.firstaviation.com

www.apiparts.com

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