2006 Annual Report

TABLE OF CONTENTS

1 Highlights of the Year

2 Letter to Shareholders

4 Management's Discussion and Analysis

28 Management's Responsibility for Financial Reporting

29 Auditors' Report

30 Consolidated Balance Sheets

31 Consolidated Statements of Operations and Deficit

32 Consolidated Statements of Cash Flows

33 Notes to Consolidated Financial Statements

IBC Corporate Information

2006 HIGHLIGHTS

- Revenue increased 13% to $37.1 million
- Debt virtually eliminated
- Year-end cash and equivalents of $13.6 million
- Invested $3.2 million in Atlantis Systems America in 2006

- Atlantis Systems America
  - Establishes 27,000 square-foot facility in Orlando, Florida
  - Commences delivery of courseware to Atlantis customers
  - Over 50 employees at year-end
  - Completes rigorous process of qualifying as U.S. Defense contractor subsequent to year-end

- Atlantis Systems International
  - Commences delivery of work in the nuclear sector
  - Awarded EH-101 helicopter procedures trainer
  - Awarded contract to upgrade three Boeing 767 trainers for Air Canada
  - Awarded contract to provide weapons load trainers for the Canadian Forces' CF-18 fleet
  - Awarded contract to provide ongoing maintenance and support for Airbus 320 flight training devices for Spirit Airlines
  - Recognized $26 million in revenues from CFTS program

- Award wins
  - Deloitte & Touche Fast 50
  - Deloitte & Touche and Fast 500
  - Ontario Chamber of Commerce Small Business Award

LETTER TO SHAREHOLDERS

In 2006 we had record financial results from our Canadian operations, we established a new subsidiary in the United States and we started work on our first contracts in the burgeoning nuclear power sector. Today, we are ready to exploit increasingly diverse opportunities in the military, civil aviation, energy and other industrial sectors worldwide and focus our energies on growth.

Revenues grew satisfactorily, though they continue to be lumpy quarter-to-quarter. Consolidated revenues for the year totaled $37 million, an increase of approximately 13 percent over 2005. The increase came from the continuing strength of our Canadian operations, which showed a 56 percent increase in revenues generated from the Contracted Flying Training and Support (or CFTS) program for the Canadian Forces and the continued acquisition of new contracts and extensions from the customers of the Canadian division, Atlantis Systems International. In 2006 Atlantis successfully sold support services that began to create annuity streams, however more are required. The hard work, dedication, creativity and technical strength of these employees are the heart of the Company.

We understood as we entered 2006 that earnings could not keep pace while we pursued our strategy of expansion and diversification. The net loss for the year was $1.4 million compared to net income of $1.7 million in 2005, with the major effect on earnings being the $3.2 million spent to establish Atlantis Systems America (ASA). We expect this investment will bear fruit as ASA pursues contracts directly and earns margins as a result.

As we closed 2006 we moved towards a structure under which strategic business units focus on delivering specific solutions to chosen markets or customers. This structure completes our transformation from a simulation-based products company to a full-service provider of integrated training solutions. Our intellectual properties and know-how, the keys to market differentiation, consist of competencies in the processes by which humans learn and manage knowledge. These will be lead and integrated across ASI, ASA and other strategic business units by practice leaders attuned to the complex training needs of our customers.

We continue to leverage the CFTS program to cultivate new opportunities for growth. In conjunction with the Department of National Defense, we have taken the lead for the Allied Wings consortium in marketing the capabilities of the CFTS program to potential military customers around the world. This initiative is providing important contacts and valuable insight into the training needs of the Canadian and foreign militaries.

During the year we continued to diversify our base of aviation customers and won new aviation contracts including the provision of an EH-101 helicopter cockpit procedures trainer to the Royal Danish Air Force, upgrading Boeing 767 flight training devices for Air Canada, providing weapons load trainers for Canada’s CF-18 fleet, and ongoing maintenance for two Airbus 320 flight training devices for Spirit Airlines. The weapons load trainer fills out our overall simulation training solution for the F-18.

With the launch of ASA early in 2006 we now have an established presence in the world’s largest military market. The increasing complexity of defense systems is driving the need for mission-critical, simulation-based training, and the U.S. government is by far the largest customer in the sector. During the year, we were able to recruit many excellent individuals to ASA and strengthen our relationships with prime contractors such as Boeing and Lockheed-Martin.

Subsequent to year end, on April 10, 2007, we announced that ASA had completed a Defense Contract Audit Agency (DCAA) audit, had adopted the ASI ISO 9001-registered quality processes, and had qualified as a subcontractor under U.S. Navy and U.S. Army Indefinite Delivery / Indefinite Quantity contract vehicles. We also announced that ASC and ASA had entered into a Special Security Agreement with the U.S. Department of Defense. This agreement meets U.S. national security objectives and it enhances our ability to provide products and services to the U.S. Department of Defense and other agencies. On April 26, 2007, ASA was awarded its first direct contract - a U.S. $2.7 million contract to provide simulation products for a customer in the U.S. defense sector.

We continue to apply our skills and diversify our revenue in new industry sectors. Nuclear power is a natural fit for us and through 2006 we pursued and signed contracts for hardware and software engineering support services. The mission-critical nature of nuclear power plant operations matches our strategy of focusing on complex, costly and potentially dangerous regulated situations. We see significant demand for simulation-based training in this market as the number of new and rebuilt nuclear plants grows in response to demands for clean energy.

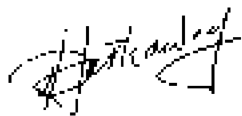
We remain confident about our prospects and the overall strength of Atlantis. We will continue to invest to build and smooth revenue growth, to spread the costs of operating in the public markets and to create the scope and scale that will insulate against economic vagaries. We have eliminated almost all of our debt, our markets remain healthy and the demand for increasingly modern, cost-effective training solutions is growing in every sector that meets our criteria for sustainability and strong margins.

We have two farewells to make. The first is on a somber note, for when Larry Roush died last autumn ASA lost its first President and one of its founders. It was an unexpected and sad day.

The second farewell is to John Kalas, our CFO. John was a driving force in helping to transform Atlantis into what it is today. He helped keep Atlantis on strong financial footing, and helped position us for continued growth in the future. We thank him for his contributions and hope to continue our excellent relationship in the future.

Finally, we offer our thanks and appreciation to our team. There are more than two hundred highly-skilled men and women on that team in Brampton, Orlando, and at customer sites across Canada and the United States. They have made Atlantis' continuing progress possible. With their dedication and hard work, and the continued loyalty of our partners and customers, we are confident that our quest remains firmly on course.

Sincerely,



Donald B. Hathaway, FCMC, ICD.D

Chairman of the Board

Andrew Day

President & CEO

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") explains the financial condition and results of operations of Atlantis Systems Corp. ("our Company" or "we" or "our" or "us") as at and for the year ended December 31, 2006 with comparisons to the year ended December 31, 2005, along with the three months ended December 31, 2006 with comparisons to the three months ended December 31, 2005 and the three months ended September 30, where applicable. This MD&A is intended to assist shareholders and other readers to understand our business and the key factors underlying our financial results. This MD&A should be read in conjunction with our audited Consolidated Financial Statements and the accompanying notes as at and for the years ended December 31, 2006 and 2005. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are stated in thousands of Canadian dollars except where otherwise noted. All tabular amounts are expressed in thousands of Canadian dollars except per share amounts. This MD&A is based on information available as at March 30, 2007 except where otherwise noted.

FORWARD-LOOKING STATEMENTS

Forward-looking statements look into the future and provide an opinion about the effect of certain events and trends on the business. Forward-looking statements may include words such as "plans", "intends", "anticipates", "should", "estimates", "expects", "believes", "indicates", "targeting", "suggests" and similar expressions.

This Annual Report and MD&A, and in particular the Business Outlook for 2007 on page 24, contain forward-looking statements. These forward-looking statements are based on current expectations and various estimates, factors and assumptions and involve known and unknown risks, uncertainties and other factors. The material factors and assumptions that were applied in making the forward-looking statements in this Annual Report and MD&A include assumptions regarding: the proportion of in-house and subcontractor work on the Contracted Flying Training and Support ("CFTS") program and the ability of subcontractors to meet deadlines; the level of activity under the CFTS program; the completion profile of new and existing projects; the cost to complete existing contracted work; the performance of contracts in accordance with their terms; the proportion of CFTS to non-CFTS revenue; the number of stock options to be granted in the future; the completion date, development of applications, market and market share for our Helicopter Vocational Trainer ("HVT") product; the level of capital programs to be completed; expected developments in the nuclear industry; ASA's capability to deliver courseware, the level of spending on our direct U.S.-market initiative; and the fair value of our Company exceeding its carrying value in the financial statements, including goodwill.

It is important to note that:

- Unless otherwise indicated, forward-looking statements in this Annual Report and MD&A describe our expectations as of March 30, 2007.
- Readers are cautioned not to place undue reliance on these statements as our actual results, performance or achievements may differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements if known or unknown risks, uncertainties or other factors affect our business, or if our estimates or assumptions prove inaccurate. Therefore, we cannot provide any assurance that the predictions of forward-looking statements will materialize.
- We assume no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or for any other reason, except as required by applicable securities laws and regulations.

Material factors that could cause our actual results to differ materially from the forward-looking statements in this Annual Report and MD&A include risks and uncertainties relating to but not limited to: the CFTS program; reliance on subcontractors; our U.S. subsidiary, ASA; reliance on key customers; the level of military expenditures and developments in the nuclear industry; HVT sales; relationships with existing U.S. prime contractors; and the availability of skilled personnel. For additional information regarding risks and

uncertainties that could affect our business, please see the Business Risk Factors section of this MD&A and the Description of the Business – Risk Factors section in our Annual Information Form, both of which are available on the System for Electronic Data and Retrieval (SEDAR) at www.sedar.com.

Additional information regarding our Company is contained in filings with securities regulatory authorities, including our Annual Information Form and Management Information Circular. These documents are available on SEDAR or on our website at www.atlantissi.com.

COMPANY OVERVIEW

We are a globally recognized training integrator for customers in the military, commercial aviation sectors and have launched a new area of activity to service the training needs of the energy sector. We combine desktop and full-flight simulation, knowledge management, learning management systems, flight training devices and multimedia courseware to provide integrated flight training and aircraft maintenance training to a list of global customers. For over twenty-eight years, we have drawn on our extensive engineering background and proprietary technology to offer cost-efficient, state of the art alternatives to real-life conditions and situations.

Simulation is economically justified when trainees or bystanders face a high degree of risk while a trainee gains skills and experience in operating equipment, when equipment is highly capital-intensive and thus expensive to use for operational or maintenance training, or when operating scenarios are complex. Simulation results in more efficient equipment utilization and superior operator performance, and growing recognition of this reality will continue to drive growth in worldwide simulation markets.

While we serve simulation customers in both the commercial aviation and government sectors, weakness over the past years in the commercial aviation sector has lead us to a greater emphasis on military sales. Within the military sector, the increasing complexity of combat systems continues to strengthen the economic argument for mission and training simulation.

In recent years, military and domestic security expenditures in Canada and the United States have increased. We expect these higher spending levels to continue for the foreseeable future. The single largest market for simulation products in both sectors is the United States government, and our expansion into the United States is an important step towards our strategic goal of expanding our existing relationships with American defence contractors and pursuing contracts directly with the U.S. government, where appropriate.

The energy market continues to represent a clear and logical opportunity for us. Environmental concerns, especially with respect to global warming, coupled with increased demand for electricity in both the developed and developing world and the aging of the installed base of nuclear power plants, is expected to lead to rapid growth in new nuclear power plant projects worldwide, as well as to the retrofitting of many existing plants. All new installations and major rebuilds require a simulated control room and we are in an excellent position to compete for these projects on our own or with appropriate partners. We have entered the energy sector through contracts to provide simulation support services (including hardware) for nuclear power generators in Canada – which signifies progress towards our strategic objective of diversifying into other markets.

We are registered under a number of quality management programs including ISO 9001:2000, AS 9100:2004, CSA-Z299.1-1985, Boeing BQMS D6-82479 and Rockwell Collins RC-9000, among others.

We operate in the United States through our wholly-owned subsidiary Atlantis Systems America, Inc. (“ASA”). We operate in Canada and the rest of the world through our wholly-owned subsidiary Atlantis Systems International Inc. (“ASI”).

At December 31, 2006, we had a total head count of 204, of which 55 were based at ASA in Orlando, Florida.

OVERVIEW AND HIGHLIGHTS

Early in 2006, we completed the transformation of Atlantis from a simulation-based products company to a provider of integrated training solutions, expanded our geographical diversification through the expansion and staffing at our U.S. operations and diversified into the energy industry. During the year, we eliminated almost all of our debt through the repayment (for cash) of our $3 million convertible secured debenture. In addition, revenue for 2006 increased 13% over 2005. However, we recorded a loss of $1.4 million for the year (versus net income of $1.7 million in 2005), primarily due to our expansion into the U.S. marketplace (a $3.2 million expense) and a total of $0.8 million in non-cash charges related to the requirement to report the debenture as a current liability and repayment of the debenture mid-year. Excluding these non-cash charges, these results included a profit from our Canadian operations of $2.6 million, a 40% increase over Canadian results in 2005. At the end of the year, we had order backlog of $49.9 million, which included over $18 million in support services through the twenty-year life of the support phase of the Canadian Department of National Defence ("DND") CFTS program. By the end of the 2006, our Orlando, Florida based operation had developed a new courseware capability that we used to deliver courseware to the Canadian Forces ("CF"), as part of our commitment to the CFTS program. This courseware capability will enable us to further evolve into an integrated training solutions provider.

Highlights

- Early in the first quarter, we announced our first contract in the nuclear power sector, to provide engineering resources and simulation expertise to a large Canadian nuclear power generator. This first contract was extended in the third quarter and a second nuclear power utility in Canada awarded us a contract in the second quarter of 2006.
- In February 2006, we announced the formal launch of our U.S. operations and the opening of our operating facility in Orlando, Florida. The focus was to create an infrastructure that would support bids, be able to deliver on winning bids, abide by all U.S. Federal government contracting processes and procedures and enable ASA to apply for security clearance from the U.S. Federal government.
- In May, at our annual and special meeting of shareholders, shareholders approved the adoption of a new by-law and a revised stock option plan, updating both to conform to standards current at that time.
- As of June 30, 2006, we were in breach of one of the financial covenants of our $3.1 million convertible debentures (one debenture was for $3.0 million and the second debenture was for $0.1 million). Following a request from the holder, the $3.0 million convertible secured debenture was repaid on August 16, 2006 using available cash on hand.
- During the third quarter we announced the following contract wins to:
  - provide an EH-101 helicopter cockpit procedures trainer to the Royal Danish Air Force ("RDAF") through prime contractor AgustaWestland;
  - upgrade three existing Atlantis Boeing 767 flight training devices for Air Canada;
  - provide weapons load trainers to the CF for the CF-18 aircraft fleet;
  - provide ongoing maintenance for two Atlantis Airbus 320 flight training devices for Spirit Airlines; and
  - extend an existing contract with a customer in the nuclear power sector to provide engineering resources and simulation expertise.

The combined value of these contracts was approximately $12.1 million.

- In the second quarter, the Quality Management Institute awarded us a perfect score of 100% on both our hardware and software registrations under the Aerospace standard AS9100B, and in the third quarter we successfully qualified under the CSA-Z299.1 quality standard, used extensively within the nuclear industry.

- In the third quarter, we won a number of awards, including the Small Business award by the Ontario Chamber of Commerce and the Deloitte & Touche Fast 50 and Fast 500, which go to the fastest growing technology companies in Canada and North America, respectively.
- As of December 31, 2006, there were just under 53 million common shares outstanding. During 2006, approximately 13.3 million warrants to purchase common shares at various prices expired, leaving approximately 3.8 million warrants outstanding as of December 31, 2006. Also during the year, options to purchase common shares increased by approximately 0.2 million leaving a balance of just over 6.1 million options outstanding as of December 31, 2006.
- In the fourth quarter, an update of cost estimates to complete multiple-deliverable contracts resulted in a $1,552 increase in revenue and a $1,050 increase in cost of revenue.
- At the end of 2006, Atlantis held cash and cash equivalents of $13.6 million (excluding restricted cash of $2.1 million) compared to $8.8 million at the end of 2005.

The CFTS Program

Early in the second quarter of 2005, the Allied Wings consortium (we are one of five members led by Kelowna Flightcraft Ltd. as the prime contractor) was awarded a $1.77 billion contract for the CFTS program by the Department of National Defence (the "DND") and the CF to provide the design, development, installation, operation and support of the CFTS' ground-based training system in Southport, Manitoba for a twenty-three year period. The contracting process was concluded in the fourth quarter of 2005 with our signing of subcontracts with Kelowna Flightcraft, the CFTS prime contractor. This resulted in the replacement of the initial enabling contract that had allowed us to commence work under the CFTS program and spend up to $30 million without risk to us. Our portion of the contract, which started in 2005, is expected to generate approximately $65 million in revenues in the initial phase and a further $18 million in support services for a twenty-year period following the initial phase. The initial phase of our contribution to the CFTS program involves the provision of an integrated training solution to the consortium. Some components of this solution will be developed and manufactured by us, (previously referred to as the "in-house" portion) while a significant portion will be provided by other companies (previously referred to as the "subcontract portion").

In conjunction with the DND, we have also commenced activities as the marketing lead for the Allied Wings consortium tasked with marketing the capabilities of the CFTS program to military customers worldwide. We will participate in any revenues arising from this marketing role.

Throughout 2006, we continued to deliver on our commitments under the CFTS program. Under the CFTS program, we are responsible for the development and integration, in the initial phase of CFTS' ground-based training system. Also, we are responsible for support of this system for a further twenty-year period. To satisfy our responsibilities under our contracts with Kelowna Flightcraft in relation to the CFTS program we are using both subcontractors and in-house capabilities. To date, we have recognized revenues of $16.8 million in 2005 and $26.3 million in 2006, for a total of $43.1 million, leaving approximately $40 million to be recognized over the term of the contract. Our strong cash position at December 31, 2006 is primarily due to a combination of advance payments received and the delivery of commitments and achievement of milestones under this contract since the beginning of this program.

Restatement

We have recently reviewed our revenue recognition for contracts with multiple deliverables, including our prior year assessment that certain contracts contained separate units of accounting. As the assessment is that such contracts, which have initial phases and then provide for support services, do not qualify as separate units of accounting and should be treated as single contracts rather than as two separate contracts, we have restated our revenue for the year ended December 31, 2005. The result of correcting this error is

that we have reduced revenue and cost of revenue for 2005 by $697 and $483, respectively. As at December 31, 2005, deferred revenue increased by $697 and accrued costs on percentage of completion decreased by $483. This correction decreased the basic and diluted net income per share for 2005 by $0.01 per share to $0.03 per share. The restatement does not affect periods prior to January 1, 2005.

Selected Annual Information

	2006	2005 Restated	2005 As Previously Reported	2004
Revenues	$37,115	32,937	$33,634	$15,943
Gross margin	10,863	9,508	9,722	5,774
Gross margin percentage	29.3%	28.9%	28.9%	36.2%
Operating expenses (G&A, S&M and stock options)	10,973	6,371	6,371	4,194
Interest expense and financing costs (net)	1,103	529	529	1,125
Other (income) / expenses	(224)	714	714	-
Net (loss) income	(1,435)	1,704	1,918	12
Net (loss) income per share (basic)	($0.03)	$0.03	$0.04	$0.00
Total assets	38,743	35,855	35,855	20,179
Total long-term financial liabilities[(1)]	-	2,035	2,035	-

(1) 2006 excludes the $100 convertible debenture included in current liabilities

Revenues of $37,115 for 2006 were 13% higher than 2005 primarily due to revenues generated on the CFTS program (which itself increased 56% over 2005 levels), which represented 71% of revenues in 2006 versus 51% of revenues in 2005. Revenues of $32,937 for 2005 were 107% higher than 2004 primarily due to initial revenues generated on the CFTS program (of $16,785).

The increase in gross margin dollars for 2006 and 2005 were consistent with the fluctuations in revenue for each of 2006 and 2005 because the gross margin percentage was virtually the same. Gross margin percentage remained consistent despite the increase in lower-margin CFTS revenue because of production efficiencies and lower production costs incurred in 2006. In 2005, the gross margin percentage decreased to 28.9% from 36.2% in 2004 primarily due to lower margins realized on the CFTS program (when compared to our other projects), which represented approximately 51% of total 2005 revenues versus nil in 2004.

Operating expenses (defined as combined general and administrative ("G&A"), selling and marketing ("S&M") and stock option expenses) have increased significantly over the past three years. From 2004 to 2006, operating expenses have increased by 162%, while revenues increased by 128% over the same period. Excluding the combined operating expenses incurred in 2006 by ASA (of $3,150), the increase in operating expenses from 2004 to 2006 was 87% versus an increase in revenues for the same period of 128%. ASA did not recognize any revenue or sign any contracts in 2006.

Interest expense and financing costs (net of interest income), increased in 2006 over 2005 due to the inclusion of a $1,064 charge attributable to the requirement to report the debt component of the $3.1 million convertible secured debentures (the "Debentures") as a current liability due to the breach of one of the financial covenants contained in the Debentures at June 30, 2006. This was partially offset by an increase in interest income of $420 as a result of higher cash balances on hand during 2006. Interest expense in 2005 primarily represented carrying charges for the Debentures and financing fees paid to Canadian Commercial Corporation. Interest expense and financing costs for 2004 were significantly higher than 2005 due to both the high level of fees related to financial restructuring activities and costs relating to the financing of accounts receivable in 2004. The 2006 charges of $1,064 discussed above will not recur.

Other income in 2006 of $224 represented the gain on extinguishment of the $3.0 million convertible secured debenture in the third quarter which is discussed below. Other expense in 2005 of $714 represented the recognition of a previously disclosed contingent liability that has now been recognized.

Net loss for 2006 of $1,435 included: a net charge of $840 related to the requirement to disclose the debenture as a current liability and the repayment of the $3.0 million convertible secured debenture; expenses (including other costs, depreciation and bank charges) incurred by ASA of $3,241 (with no offsetting revenue or contribution to gross margin); and earnings of $2,646 recognized by ASI. Net earnings for 2005 of $1,704 included expenses incurred by ASA of $189 (following its start-up in the fourth quarter of 2005) and earnings of $1,893 recognized by ASI. Results for 2004 were essentially break-even and are fully attributable to ASI. In summary, the underlying trend of these results from 2004 through 2006 shows improved profitability in ASI as revenues have increased, offset by our decision to invest in ASA to position us to take advantage of the largest market for products such as ours.

Total assets of $38,743 at December 31, 2006 represented an increase of 8% over the 2005 amount of $35,855. The increase is primarily due to break-even cash flow from operations (before net change in non-cash working capital) despite the reported loss of $1,435 supplemented by cash from additional deferred revenue (primarily deposits from customers) decreased by cash used for the repayment of the $3.0 million convertible secured debenture. Total assets of $35,855 at December 31, 2005 represented a significant increase over the 2004 amount of $20,179 primarily due to the increased business activity surrounding the CFTS program (in the form of additional accounts receivable and unbilled revenue), the common share and convertible secured debenture issuances during 2005 (accounting for most of the increase in cash and cash equivalents) and the investment in capital assets and deferred development costs throughout 2005.

There were no reported long-term liabilities at December 31, 2006 as a result of the repayment of the $3.0 million convertible secured debenture and the requirement to classify the remaining $100 convertible debenture as a current liability from June 30, 2006 onwards. Total long-term liabilities in 2005 represented the carrying value of the Debentures that were to be accreted to $3.1 million by March 31, 2008.

RESULTS OF OPERATIONS

The following is a discussion of the material factors influencing the operating results and the financial condition of our Company, as at and for the year ended December 31, 2006 with comparisons to the year ended December 31, 2005, where applicable.

The Consolidated Statements of Operations and Deficit for 2006, with the comparative numbers for 2005, reflect the operations of our operating entities, ASI and ASA, and corporate overheads. All revenues for 2006 and 2005 were generated by the Canadian operating entity, ASI.

Revenues

The components of revenue for the years ended December 31, 2006 and 2005 are as follows:

	Year Ended 2006		Year Ended 2005			
			Restated		As Previously Reported	
	$	**% of total**	$	% of total	$	% of total
CFTS	**$26,253**	**71%**	$16,785	51%	$17,482	52%
IMTS	**5,341**	**14%**	8,963	27%	8,963	27%
RDAF	**2,229**	**6%**	-	-	-	-
Nuclear Sector	**579**	**2%**	-	-	-	-
Other	**2,713**	**7%**	7,189	22%	7,189	21%
Total	**$37,115**	**100%**	$32,937	100%	$33,634	100%

We realized consolidated revenues of $37,115 in 2006, versus revenues of $32,937 for 2005, an increase of 13%. For 2006, 71% of revenues were generated from the CFTS program versus 51% for 2005. For the CFTS program, we began to recognize revenue upon commencement of work performed internally and by our subcontractors in the second quarter of 2005 under the terms of an initial enabling contract with Kelowna Flightcraft, the CFTS prime contractor. The final contracts with Kelowna Flightcraft were signed in the fourth quarter of 2005. In 2005, we recognized CFTS-related revenues of $16,785. In 2006, CFTS revenues increased by 56% to $26,253, which included for the first time revenue recognized by ASI arising from the delivery of courseware created by ASA, acting as a subcontractor to ASI under the CFTS program. We expect ASA to continue to develop and deliver courseware for the CFTS program through 2008. CFTS revenue is expected to fluctuate over 2007 and 2008 depending upon the proportion of work performed in-house (including by ASA) in any given period and achievement of milestones by our subcontractors on the program.

When appropriate, we deliver services to foreign customers or prime contractors through Canadian Commercial Corporation, which may act as a contractual intermediary and guarantees contract completion. However, the following discussion of our revenues identifies the end customers who ultimately received the products and services.

In 2006, revenues from integrated maintenance training systems ("IMTS") projects amounted to 14% of total revenues versus 27% for 2005. This reflects sales of IMTS under contracts with the armed forces of Canada, the United States and Australia. In the second quarter of 2006, the CF awarded us a contract to provide weapons load trainers (which expands our IMTS offering) for the CF-18 aircraft fleet, along with support services for the weapons load trainers through 2020. Revenues recognized in 2006 on IMTS contracts awarded in 2005 were $2,816 from the Royal Australian Air Force ("RAAF"), $1,744 from the CF, and $335 from the U.S. Navy. In addition, revenues of $446 were recognized in 2006 from award of weapons load trainers from the CF and work is expected to continue through 2007 and into early 2008 on this contract.

In the second quarter of 2005, we were awarded an $8.8 million contract to upgrade the RAAF IMTS suite to maintain currency with required aircraft modifications. As well, in the third quarter of 2005, we were awarded a $2.2 million follow-on contract to upgrade the IMTS suites delivered to the CF in 2005. During 2005, revenues recognized on the RAAF contract were $3,543 and on the CF contract were $272. Revenues recognized in 2005 on IMTS contracts were $1,963 from the RAAF, $3,815 from the CF and $3,186 from the U.S. Navy's virtual environment maintenance trainers. Total IMTS revenues of $8,963 represented 27% of total revenues in 2005.

The reduction in IMTS revenues from 2005 to 2006 of $3,622 (a 40% reduction) was due to the completion of contracts with the U.S. Navy and the CF in early 2006.

In the third quarter of 2006, we were awarded a contract to provide a cockpit procedures trainer to the RDAF for the EH-101 helicopter through prime contractor AgustaWestland (which will be delivered over the next twenty-four month period). Revenues of $2,229 were recognized on this program in 2006.

Revenues from customers in the nuclear sector were $579 for the year ended December 31, 2006, or 2% of revenue. This strategic market initiative was begun in late 2005 and we signed our first contract in this sector in the first quarter of 2006, with two additional contracts signed for hardware and software engineering services through the rest of the year.

Other revenues in 2006 of $2,713 included revenue of $516 from the upgrade of our existing Atlantis Boeing 767 flight training devices for Air Canada, along with $1,242 derived from a number of small, short-duration contracts. Other revenues in 2005 of $7,189 consisted primarily of completion of work on two of our Atlantis Airbus 320 flight training devices of $2,006, $1,390 for the completion of the CC-130 program upgrades for the CF, the additional revenue from a contract termination of $924 and $2,303 derived from a number of small, short-duration contracts.

During 2006, while we had contracts with many customers, one customer, the CF represented 77% of revenue. In addition, as at December 31, 2006, the same customer represented 77% of combined accounts receivable and unbilled revenue. In 2006, our second largest customer represented 8% of revenue with no outstanding balance of accounts receivable and unbilled revenue at year end.

During 2005, one customer, the CF, represented 56% of revenue, and 46% of combined accounts receivable and unbilled revenue at year end. The second largest customer in 2005 represented 17% of revenue and 17% of combined accounts receivable and unbilled revenue at year end.

The order backlog at December 31, 2006 was $49.9 million, consisting of $40.5 million from the CFTS program (which includes $18.4 million (an increase of $0.4 million over the previous year) in support services for the twenty-year support period) and $9.4 million from all other contracts, a decrease of $22.1 million over the comparable backlog of $72.0 million at December 31, 2005. The decrease of $22.1 million reflects a $25.8 million reduction on the CFTS program, offset by a $3.7 million increase in the non-CFTS order backlog. The $9.4 million of non-CFTS order backlog reflects a balance of $5.7 million at January 1, 2006, supplemented by new orders of $14.7 million during 2006, offset by $11.0 million of revenue recognized on these contracts during 2006. We expect between 45% and 55% of the order backlog to be realized as revenue in 2007.

Order backlog at December 31, 2005 was $72.0 million, consisting of $66.3 million from the CFTS program (which included $18 million in support services through the twenty-year support period) and $5.7 million from all other contracts. The non-CFTS order backlog of $5.7 million represented an increase of $1.9 million over the comparable backlog of $3.8 million at December 31, 2004. The CFTS order backlog of $66.3 million reflected orders first reported in 2005.

Order backlog is defined as that portion of a legally binding commercial agreement that provides sufficient detail on our obligations and our customers' obligations to form the basis for a contract and an order that has not yet been recognized as revenue.

Gross Margin

Gross margin for 2006 was $10,863 or 29.3%, compared with gross margin of $9,508 or 28.9% in 2005. The increase in the dollar value of gross margin reflects the higher revenue in 2006 versus 2005. The gross margin percentage remained constant despite the proportionate increase in lower-margin CFTS revenue from 51% of total revenue in 2005 to 71% of total revenue in 2006. This year-over-year consistency was achieved through efficiencies realized in fixed and variable production costs in 2006 versus 2005.

Gross margins are expected to fluctuate between 25% and 35% going forward depending on the mix in a particular quarter between CFTS and non-CFTS revenue and the amount of revenue we anticipate will be recognized by ASA, which we expect will initially generate lower margins due to competitive pressures, lack of economies of scale and start-up inefficiencies.

Gross margin for 2005 was $9,508 or 28.9%, resulting from the significantly lower margins realized on the revenues from the CFTS program, which represented 51% of total 2005 revenue. The gross margin percentage decrease was offset slightly by the one-time settlement of an outstanding claim in the third quarter of $924 which resulted in the recognition of revenues with no offsetting costs recorded in cost of revenue.

Operating Expenses

We incurred G&A expenses of $7,504 for 2006, versus $3,580 for the same period in 2005, a 110% increase. The 2006 increase includes $2,064 incurred by ASA as a result of our direct expansion into the U.S. marketplace and the balance of $1,860 is due primarily to increased personnel-related costs, including the hiring of additional management and finance personnel to support both the rapid growth of our existing contract base, our anticipated future business activity and increased costs related to compliance with regulatory requirements.

S&M expenses of $3,239 for 2006 represent a 57% increase over the $2,066 incurred in 2005. The 2006 increase includes $1,086 incurred by ASA as a result of our direct expansion into the U.S. marketplace and the balance of $87 reflects comparable personnel levels within marketing and spending on marketing programs and conferences.

In 2005, we spent $189 towards our direct expansion into the U.S. marketplace, most of which was included in both G&A and S&M following its start-up in the fourth quarter of 2005. We expect combined spending at ASA to increase over 2006 levels reflecting the full-year effect of investment decisions made in 2006 in anticipation of 2007 revenue generation. Additional spending on G&A and S&M is expected to occur in 2007 provided ASA is successful in winning new orders (in addition to those as a subcontractor to ASI).

We incurred stock option expenses of $230 for 2006 versus $725 for 2005. The significant reduction in stock option expense year over year reflects the reduction in the amount of options granted in 2006 versus 2005, as well as the significant number of options issued in 2005 with vesting periods of less than three years. The remaining compensation-related costs will be expensed over a three-year period at the rate of approximately $167 for 2007, $121 for 2008 and $15 for 2009.

Research and development ("R&D") expenses of approximately $76 for 2006 were included in cost of revenue, down significantly from the $447 incurred in 2005. In both years, we spent minimal amounts on R&D excluding that portion capitalized and discussed below. These expenses represented an investment in the development of simulation-based training intellectual property. Additional R&D is integrated into large simulation contracts and is expensed through cost of revenue. Also, during 2006 and 2005, we funded and capitalized costs related to the development of our virtual-reality, full-motion helicopter simulator (referred to as HVT). Costs of $127 and $1,542 were capitalized in 2006 and 2005 respectively. We expect this development project will be completed in 2007 and we expect to recover this investment through market opportunities that are expected to arise from the introduction and commercialization of this technology beginning in 2007. No amortization has been recorded to date. In 2007, we will continue to invest in R&D initiatives that we believe will lead to further market opportunities, however, capitalization of R&D expenditures will depend on the initiatives' ability to meet the required tests for capitalization.

Other Items

We incurred depreciation and amortization expense of $446 in 2006 versus $190 in 2005. The significant increase of $256 primarily reflects the investment in capital assets in 2006 of $1,266 and the investment of $637 in 2005. Of the $1,266 spent in 2006, $441 is attributable to ASA. We expect depreciation and amortization expense will increase in 2007 versus 2006 due to the level of investment in 2006 and further anticipated investment in 2007.

Interest expense and financing costs (net of interest income) of $1,103 were incurred in 2006 versus $529 in 2005, an increase of 109%. The 2006 amount represents interest paid on the Debentures of $197, accretion of the carrying value to par (at March 30, 2008) of $177 (to June 30, 2006), amortization of deferred financing costs of $47 (to June 30, 2006) and bank service charges, support fees and other costs of $176 offset by interest income of $558.

The remaining interest expense and financing costs balance of $1,064 was incurred in the second quarter as a result of our breach of a financial covenant contained in the Debentures, as at June 30, 2006. The breach constituted an event of default under the Debentures, entitling the holders of the Debentures, at their option, to accelerate payment of outstanding principal and accrued interest. The Debentures were secured against all of the assets of our Company and if payments were not made in accordance with the terms of the Debentures, the Debenture holders had the right to enforce their security against our Company. The Debentures were issued on April 4, 2005. The proceeds of $3.1 million were initially allocated between the debt and equity values of the financial instrument based on the terms of the conversion feature. At April 4, 2005, the proceeds (pre-financing costs) were allocated $1,815 to the debt

component and $1,285 to the equity component of the financial instrument. In the five quarters since the issuance of the Debentures to June 30, 2006, the debt component had increased by $397 due to the accretion of the principal amount to $2,212. The accretion would have continued until the carrying value of the debt component reached the par value of $3,100 at March 30, 2008, the maturity date of the Debentures. The breach of one of the financial covenants as at June 30, 2006 constituted an event of default under the Debentures and accelerated the recognition of the remaining accretion as a result of the requirement to report the debt component of the Debentures as a current liability. The $1,064 amount consists of the difference between the carrying value of the Debentures just prior to the event of default of $2,212 and the redemption value of $3,100 (par value) being $888 plus the immediate recognition of the remaining unamortized deferred financing costs (related to the original issue of the Debentures) of $176. These deferred financing costs were being amortized over the life of the debt component which was to mature on March 30, 2008.

In August, 2006, the holder of the $3.0 million convertible secured debenture requested accelerated repayment and was repaid on August 16, 2006. As mentioned above, the consideration paid to the debenture holder has been allocated to the liability and equity elements of the security on a basis consistent with the original allocation. The equity component was re-valued on the date of extinguishment using the Black-Scholes model. This resulted in a gain on extinguishment of the debenture of $224 being recognized.

The $100 convertible debenture holder did not request repayment, and this convertible debenture is still outstanding. As at December 31, 2006, we were in breach of two of the financial covenants contained in the $100 convertible debenture, for which we received a waiver from the holder.

There was no additional accretion expense or amortization of deferred financing costs beyond the second quarter of 2006 since both items were fully recognized at that time as a result of the covenant breach.

Interest at the prescribed rate of 10% per annum of the par value was paid on the $3.0 million convertible secured debenture until its repayment on August 16, 2006, and interest at the prescribed rate of 10% per annum of the par value of the $100 convertible debenture will continue to be paid until maturity (March 30, 2008).

The 2005 amount of $529 of interest expense and financing costs (net of interest income) primarily represented interest paid on the Debentures of $233, accretion of the carrying value to par (at March 30, 2008) of $220, amortization of deferred financing costs of $46, financing fees paid to Canadian Commercial Corporation of $105 and bank service charges and support fees of $63 offset by interest income of $138.

In 2007, we will continue to incur 10% interest on the $100 convertible debenture.

Due to the strong cash position at the end of 2006, we do not expect to use accounts receivable for financing in 2007 and expect any other financing to be completed on commercial terms appropriate for a company of our size and status.

Other Expenses

Other expenses of $714 in 2005 related to the recognition of a previously disclosed contingent liability that has now been recognized.

There was no income tax (recovery) expense shown for 2006 or 2005 because we had previously recorded a full valuation allowance for all future income tax assets (specifically cumulative operating loss carry-forwards and temporary differences) as we believed there was uncertainty in realizing the full benefit of these items. As a result, any income tax recovery or expense related to losses and earnings in 2006 and in 2005 were offset by utilizing an equal portion of the unrecognized operating loss carry-forwards from previous years. As at December 31, 2006, we continue to carry a full valuation allowance against our income tax assets due to the continued uncertainty surrounding their full usage. There will be no income tax expenses against earnings in Canada until either all unrecognized operating loss carry-forwards of

approximately $13.8 million are used or expire. Likewise, there will be no income tax expense against earnings in the United States until all unrecognized operating loss carry forwards of approximately $3.1 million are used or expire.

U.S. Marketplace Expenses and Charges Incurred by ASA

For 2006, costs incurred by ASA for our direct expansion into the U.S. marketplace were $3,241. No revenue or order backlog was recognized in 2006 as a result of this direct expansion into the U.S. marketplace.

For 2005, costs incurred by ASA for our direct expansion into the U.S. marketplace were $189. These costs were incurred on combined G&A and S&M expenses. No revenue or order backlog was recognized in 2005 as a result of this direct expansion into the U.S. marketplace.

Net Income

We lost $1,435 (($0.03) per share) compared to a net income of $1,704 ($0.03 per share – basic) for the same period in 2005. The calculation of net (loss) / income per share (diluted) for the years ended 2006 and 2005 did not result in any dilution versus reported basic earnings per share.

FOURTH QUARTER RESULTS

The components of revenues for the fourth quarter of 2006 and 2005 are as follows:

	Fourth Quarter 2006		Fourth Quarter 2005			
			Restated		As Previously Reported	
	$	**% of total**	$	% of total	$	% of total
CFTS	**$8,707**	**78%**	$4,956	69%	$5,653	72%
IMTS	**485**	**4%**	1,496	21%	1,496	19%
RDAF	**1,209**	**11%**	-	-	-	-
Nuclear Sector	**134**	**1%**	-	-	-	-
Other	**617**	**6%**	685	10%	785	9%
Total	**$11,152**	**100%**	$7,137	100%	$7,834	100%

Revenues for the three months ended December 31, 2006 were $11,152 versus $7,137 for the same period in 2005, an increase of 56%. Fourth quarter revenues for the CFTS program were $8,707 and $4,956 for 2006 and 2005, respectively. Fourth quarter 2006 revenues included $1,552 resulting from an update of cost estimates to complete multiple-deliverable contracts. During the fourth quarter of 2005, the contracts with Kelowna Flightcraft were finalized, necessitating a catch-up adjustment of revenue and gross margin of approximately $1,300, related to the second and third quarters once we moved from the initial enabling contract, which was cost-based, to final contracts with Kelowna Flightcraft that permitted percent-completion-based revenue recognition. For the fourth quarter of 2006, revenues from IMTS were $485 versus $1,496 in the same period of 2005, a decrease of 68% reflecting substantial completion of the F-18 IMTS upgrade projects with the RAAF, CF and U.S. Navy before the fourth quarter of 2006, offset by revenues derived from the weapons load trainers provided to the CF. During the fourth quarter of 2006, revenues from the contract announced in the third quarter of 2006 to provide a cockpit procedures trainer to the RDAF through prime contractor AgustaWestland were $1,209. In addition, Other revenues included $408 for the upgrade of our existing Atlantis Boeing 767 flight training devices to Air Canada.

Gross margin for the three months ended December 31, 2006 was $2,964, or 26.6%, versus $3,067, or 43.0%, for the same period in 2005. Fourth quarter 2006 gross margin included $502 resulting from an update of cost estimates to complete multiple-deliverable contracts. The 2005 gross margin included the approximate $1.3 million catch-up adjustment mentioned above. This one-time catch-up adjustment in 2005 increased the fourth quarter 2005 gross margin percentage from 30.5% to the reported 43.0%.

G&A expenses for the three months ended December 31, 2006 were $2,075 versus $1,564 for the same period in 2005, an increase of $511 or 33%. This increase consisted primarily of the effect of the hiring of additional management and finance personnel and additional regulatory and employee-related costs along with higher expenditures at ASA versus the fourth quarter of 2005.

For the fourth quarter of 2006, S&M expenses were $919 versus $476 for the same period last year, an increase of 93% representing the effect of additional personnel hired late in 2005 and in 2006, along with higher expenditures incurred by ASA in 2006.

Stock option expenses for the fourth quarter of 2006 were $62 versus $176 for the same period last year. The decrease is primarily due to $116 of additional costs related to revisions in the volatility and stock option expected-life assumptions used in calculating the expense recognized in the fourth quarter of 2005.

In summary, operating expenses (which represent the sum of G&A, S&M and stock option expenses) were $3,056 for the fourth quarter of 2006 versus $2,216 for the same period last year, an increase of $840 or 38%. Of this increase, $287 was due to higher operating expenses in ASI, while the balance of $553 was attributable to increases in operating expenses incurred by ASA (versus the $189 incurred in the fourth quarter of 2005).

Depreciation and amortization expenses were $140 for the three months ended December 31, 2006 versus $88 for the same period in the previous year, an increase of 59%. This increase reflects the additional capital spending in 2005 and 2006.

Interest and financing costs (net of interest income) was income of $84 in the fourth quarter of 2006 versus a $194 expense for the same period last year. The difference of $278 was primarily due to the repayment of the $3.0 million convertible secured debenture in the third quarter of 2006 along with higher interest income of $134 in 2006 versus 2005. For the fourth quarter of 2005, $157 represented interest and accretion costs relating to the Debentures issued in the second quarter of 2005.

Loss for the fourth quarter was $148 (($0.00) per share) versus net income of $569 ($0.01 per share – basic) for the same period in 2005. This decrease of $717 resulted primarily from the inclusion of the CFTS margin catch-up adjustment of approximately $1,300 in the fourth quarter of 2005, an increase in year-over-year ASA expense from $189 to $762 (an increase of $573), an increase in ASI expense from approximately $2,027 to $2,314 (an increase of $287), offset by the additional direct contribution attributable to higher revenues of $4,015 in the fourth quarter of 2006 versus the same period in 2005

The loss for the fourth quarter of 2006 included the following items of note:

- A $50 recovery for warranty and upgrade-related costs for contracts completed in 2006 and a foreign exchange loss of $36 included in gross margin;
- Recognition of additional costs related to our existing contracts resulted in a reduction in gross margin of approximately $400;
- Approximately $300 for costs associated with employee recognition and performance;
- A $1,552 increase in 2006 revenue and a $1,050 increase in cost of revenue resulting from an update of cost estimates to complete multiple-deliverable contracts; and
- Combined operating expenses (including depreciation and bank service charges) of $762 incurred by ASA as a result of our direct expansion into the U.S. marketplace.

Net income for the fourth quarter of 2005 included the following items of note:

- $1.3 million of additional gross margin relating to the catch-up for the second and third quarters of the CFTS program;
- A $176 charge for stock-based compensation of which $116 related to revisions to more appropriate volatility and stock option expected life assumptions used in calculating the expense; the volatility

assumption was revised from 35% to 53% and the stock option expected life assumption was changed from five years to three years; of this additional charge, $118 related to the first quarter 2005 expense; this non-cash charge was determined by management to be not significant to first quarter results since inclusion would not have changed our reported first quarter net loss per share (basic) of $0.02, our reported cash flow from operations of $618 or the reported shareholders' equity of $15,010;

- A $35 charge for accretion costs on the Debentures related to the second quarter of 2005 reflecting the revision to the volatility assumption from 35% to 53%;
- A $150 charge for warranty and upgrade-related costs for contracts completed in 2005;
- Approximately $700 for costs associated with trade shows, year end audit, capital taxes, recruiting fees and employee recognition and performance; and
- $189 in initial expenditures related to our direct expansion into the U.S. marketplace.

Cash and cash equivalents decreased by $1,769 in the fourth quarter primarily due to an increase in customer-related balances ($2,711), inventory ($19) and investment in capital assets ($447), which were partially offset by an increase in accounts payable ($1,492).

Summary of Quarterly Results (unaudited)

Following are the quarterly results for 2006 and 2005 including those initially reported along with the restated amounts for the fourth quarter of 2005 and the first three quarters of 2006.

	2006						
	Dec 31	**Sep 30 Reported**	**Sep 30 Restated**	**Jun 30 Reported**	**Jun 30 Restated**	**Mar 31 Reported**	**Mar 31 Restated**
Revenues	$11,152	$11,837	$11,509	$5,708	$5,923	$8,680	$8,531
Gross margin	2,964	3,898	3,794	1,521	1,589	2,562	2,516
Operating expenses*	3,056	2,649	2,649	3,028	3,028	2,240	2,240
Net income (loss)	(148)	1,477	1,373	(2,822)	(2,754)	140	94
Net income (loss) per share (basic)	($0.00)	$0.03	$0.03	($0.05)	($0.05)	$0.00	$0.00

	2005				
	Dec 31 Reported	Dec 31 Restated	Sep 30	Jun 30	Mar 31
Revenues	$7,834	$7,137	$8,471	$12,799	$4,430
Gross margin	3,281	3,067	4,349	1,512	580
Operating expenses*	2,216	2,216	1,886	937	1,332
Net income (loss)	783	569	1,554	426	(845)
Net income (loss) per share (basic)	$0.01	$0.01	$0.03	$0.01	($0.02)

* Represents the sum of G&A, S&M and stock option expenses

As previously mentioned, we reviewed our revenue recognition for contracts with multiple-deliverables and have determined that the recognition of revenue for the fourth quarter of 2005 and the first three quarters of 2006 was incorrect. The tables above reflect the corrections made to each of those four consecutive quarters.

Revenues over the eight-quarter period did fluctuate reflecting our experience with large, multi-year contracts. The quarterly revenue profile of 2005 included the initial stages of the CFTS program awarded early in the second quarter from which we received approximately $83 million in orders, $65 million of which we expected to yield as revenue over the first thirty months. CFTS revenue for the second, third and fourth quarters of 2005 were $9,199, $2,630 and $4,956 respectively for a total of $16,785.

Our quarterly revenue profile for 2006 reflects fluctuations in CFTS revenue which depended upon the proportion of work performed in-house and the achievement of milestones by our subcontractors in any given quarter. CFTS revenues for each of the quarters of 2006 were $6,134, $3,210, $8,202 and $8,707 respectively for a total of $26,253.

Gross margin over the eight quarter period reflects not only revenue changes in each quarter but also certain specific items. For 2005, these items included the sale of two Airbus A-320 flight training devices in the first quarter at cost; the high proportion of CFTS-related revenues in the second quarter; additional revenue from a contract termination of $924 included in revenue in the third quarter, and the additional $1,300 included in revenue in the fourth quarter relating to the catch-up for the second and third quarters of the CFTS program. For 2006, the lower gross margin percentage in the second quarter included a $172 foreign exchange loss, and was further reduced since manufacturing and facility costs represented a larger proportion of second quarter revenue versus the other quarters in 2006. The lower gross margin percentage in the fourth quarter included a reduction of approximately $400 due to the recognition of additional costs related to our existing contracts.

Operating expenses (defined as combined G&A, S&M and stock option expenses) have increased significantly over the eight-quarter period, reflecting our direct expansion into the U.S. marketplace through ASA starting in the fourth quarter of 2005. On a quarterly basis, these amounts were: $189, $780, $899, $729 and $742 respectively. As well, ASI has increased its spending through 2006 for personnel-related costs including the hiring of additional management and finance personnel to support both anticipated future business activity and increased costs related to compliance with regulatory requirements.

The net income (loss) for the eight quarters primarily reflects fluctuations in revenue. However, results for the second and third quarters of 2006 include the effects of the requirement to report the Debentures as a current liability ($1,064 expense) and the subsequent repayment of the $3.0 million convertible secured debenture ($224 income) respectively.

Net income (loss) per share (basic) also reflected the fluctuations in earnings over the eight quarters as well as the effect of the increase in the number of common shares outstanding from January 1, 2005 to December 31, 2006 of approximately 7.8 million common shares issued over the period, to approximately 53.0 million.

The net income (loss) per share (diluted) for the eight quarters is not disclosed since the calculation, using the treasury method, did not result in any dilution versus reported basic earnings per share in any of the eight quarters.

CASH FLOW, LIQUIDITY AND CAPITAL RESOURCES

Cash Flow

We had cash and cash equivalents of $13,636 at December 31, 2006 compared to $8,755 at the end of the previous year. The 2006 amount excludes the $2,051 of restricted cash which is related to the contract with AgustaWestland which is discussed later in this section. The sources for the changes in cash and cash equivalents for the years 2006 and 2005 are as follows:

Years ended December 31,	**2006**	2005
Cash flows provided by (used in)		
Operating activities	**$ 11,033**	$ 3,407
Investing activities	**(3,317)**	(637)
Financing activities	**(2,835)**	5,616
Increase in cash and cash equivalents	**4,881**	8,386
Cash and cash equivalents at beginning of year	**8,755**	369
Cash and cash equivalents at end of year	**$ 13,636**	$ 8,755

Operating activities

Cash flow from operating activities of $11,033 in 2006 represented a $7,626 increase over cash flow in the previous year. For 2006, the cash flows from operating activities of $11,033 were primarily due to the loss of $1,435 which was more than offset by non-cash charges included in the results for items such as depreciation and amortization, stock option expenses, accretion on the Debentures, the amortization of deferred financing costs, and the gain on extinguishment of the debenture for a total of $1,803 which were supplemented by the net change in non-cash working capital which generated $10,800 of additional cash in the year. The $10,800 cash inflow on account of net changes in non-cash working capital was primarily due to the following four items: first, an increase in deferred revenue (i.e. primarily customer deposits) attributable to both the CFTS program and the contract to provide weapons load trainers to the CF; second, a reduction in accounts receivable due to the collection of the final billings related to the IMTS contracts with the RAAF and the U.S. Navy in early 2006; third, the collection, also in early 2006, of an additional billing for a contract termination initially recognized in the third quarter of 2005 and; fourth, an increase in accounts payable.

For 2005, the cash flows from operating activities of $3,407 were primarily due to income of $1,704, supplemented by non-cash charges included in the results of $1,181, as well as the net change in non-cash working capital which generated an additional $2,193 in the year. These amounts were partially offset by the capitalization of deferred development costs of $1,542.

Cash flows from operating activities for 2006 of $11,033 represented a $7,626 increase in cash flows from operating activities from 2005. This increase was primarily due to significantly higher cash flows from non-cash working capital items of $8,607 and lower cash funding of deferred development costs of $1,415, partially offset by a lower contribution from operating results of $2,517 (including non-cash charges therein) in 2006 versus 2005.

Investing activities

Cash used in investing activities was $3,317 for 2006 versus $637 for 2005. Following are the components:

Investment in capital assets was $1,266 in 2006, a $629 increase over the $637 invested in 2005. Of the 2006 amount, $441 consists of investment in computer hardware, software, leasehold improvement and furniture and fixtures in ASA and the balance of $825 primarily represents purchases of computer hardware and communications equipment in our Brampton, Ontario operating facility. The 2005 amount consisted primarily of infrastructure improvements to the same facility. We expect such expenditures to remain at approximately current levels throughout 2007.

Cash used in investing activities also included the increase in restricted cash (cash designated and held as collateral against performance-related bonds issued on our behalf by a third party) of $2,051. This restricted cash represents the collateral provided for a letter of credit issued by a Canadian financial institution as a condition of the contract to provide a cockpit-procedures trainer to the RDAF via prime contractor AgustaWestland. We expect restricted cash to decline by approximately one half during 2007 as we achieve contract milestones that trigger the reduction in the value of the letter of credit.

Financing activities

Cash flow from financing activities for 2006 amounted to $2,835, compared to a cash inflow of $5,616 for 2005. The $2,835 outflow represented the repayment of the convertible secured debenture of $3,000 offset by proceeds from the exercise of stock options of $165, whereas the inflow of $5,616 for 2005 represented net proceeds from the issuance of common shares of $1,927, the issuance of the Debentures of $2,702, the exercise of common share purchase warrants of $1,734 and the exercise of stock options of $239, offset by the repayment of promissory notes of $986.

Liquidity

We last raised funds through equity or debt transactions in the second quarter of 2005. In 2005, we raised $2,702 through the issuance of Debentures, $1,927 through the issuance of common shares, and $1,734 through the exercise of common share purchase warrants. No funds were raised through the issuance of debt or equity in 2006. We received $165 and $239 through the exercise of stock options in 2006 and 2005 respectively. In February and March, 2007, 1,456,121 common share purchase warrants were exercised, to purchase common shares at $0.60 per share. We received proceeds of $874 as a result of these exercises.

We maintain a committed secured bank operating line of credit of up to $5.0 million with a major Canadian chartered bank. The operating line is not currently drawn. This credit facility permits us to borrow funds directly for operating and subsidiary funding purposes. The facility has financial covenants covering maximum borrowing base, a minimum current ratio and a maximum debt to tangible net worth ratio. Any advances are repayable on demand. As at December 31, 2006, we were in compliance with all financial covenants included in this facility.

In July of 2006, as a condition of the contract to provide a cockpit procedures trainer to the RDAF via prime contractor AgustaWestland, we entered into a letter of credit with a Canadian financial institution in the amount of $2,051. This letter of credit has been fully collateralized by restricting the use of an equal amount of our cash on hand with the counterparty to the letter of credit. The initial progress billings from the customer which were received in the third quarter of 2006 were approximately equal to the value of the initial letter of credit. The value of this letter of credit and the amount of restricted cash (which is reported separately on our consolidated balance sheet at December 31, 2006) will decline as contract milestones are achieved through June 2008. We expect this letter of credit to decline by approximately one half during 2007 as we achieve contract milestones that trigger the reduction in the value of the letter of credit.

During the second quarter of 2005, we issued the Debentures in the principal amount of $3.1 million. As at June 30, 2006, we were in breach of one of the financial covenants of the Debentures. In August of 2006, the holder of the $3.0 million convertible secured debenture requested accelerated repayment and was repaid on August 16, 2006. The $100 convertible debenture holder did not request repayment and this debenture is still outstanding. The $100 convertible debenture is convertible at the holder's option any time prior to April 1, 2008 into 181,818 common shares at a conversion price of $0.55 per share. We have the right to redeem this debenture until March 30, 2007 at par without premium or penalty. If we redeem this debenture by March 30, 2007, the holder will be able, for two years after redemption, to exercise common share purchase warrants to purchase 181,818 shares at $0.60 per share. We have the right to convert the principal amount of this debenture into common shares at $0.55 per share if the trading price of our common shares closes at or above $1.50 for at least ninety consecutive trading days. The terms of this debenture include covenants covering minimum amounts for working capital, a minimum working capital ratio and minimum cumulative income targets.

Capital Resources

During 2006, we granted options to purchase 1,376,875 common shares. These options carry a term of five years. Following is additional detail:

Quarter	Number of options	Exercise price	Vesting terms
First	100,000(1)	$0.62	1/8 per quarter for two years
	250,000(1)	$0.68	1/3 per year for three years
Second	500,000(2)	$0.62	1/3 per year for three years
Third	10,000(1)	$0.45	1/3 per year for three years
Fourth	516,875(3)	$0.55	1/3 immediate, 1/3 per year for two years
Full year	**1,376,875**		

(1) Issued as part of an employment contract to an officer.
(2) Issued to non-management directors of ASA.
(3) Issued to employees of ASI and ASA.

At our annual and special meeting of shareholders held in May of 2006, shareholders approved the grant of 500,000 options to purchase common shares to non-management directors of ASA, which had been granted in February of 2006 conditional on shareholder approval.

Also, at the annual and special meeting of shareholders, shareholders approved a revised stock option plan which allows for the issuance of options up to an amount equal to 15% of the issued and outstanding common shares, and which provides that any exercised options will increase the pool of options available for grant. As at December 31, 2006, based on the actual number of common shares outstanding the Plan would allow for the issuance of a total of 7,946,621 options to purchase common shares of our Company. There are currently 6,123,959 options to purchase common shares outstanding, leaving 1,822,662 options available for issuance under the Plan. The amount of options available for issuance will change as we grant options in 2007 and as the actual number of common shares outstanding changes as well.

During 2006, we issued options to purchase 1,376,875 common shares. We estimated the fair value of each option using the Black-Scholes option-pricing model under the following assumptions: dividend yield – 0%; expected volatility – 53% and 48%; and risk-free rates of 3.90% and 3.95%. For 2006, these grants of options, along with the unvested portion of the 2005 option grants resulted in compensation-related expense of $230.

During 2005, we issued options to purchase 6,248,000 common shares. These options carry a term of five years, exercise prices between $0.42 and $0.62 and have various vesting terms. Certain of these options vested immediately, while the balance vest over a two- or three-year period. In 2005, these option grants resulted in a compensation-related expense of $725.

In connection with the April 4, 2005 issuance of the Debentures, we issued 5,636,363 common share purchase warrants to the holders of the Debentures which only became exercisable if we were to initiate redemption of the Debentures prior to April 1, 2007. As previously reported, as at June 30, 2006, we were in breach of one of the financial covenants attached to these Debentures. The breach constituted an event of default under the terms of the Debentures, entitling the holders of the Debentures, at their option, to accelerate payment of the outstanding principal and accrued interest. We reported on August 15, 2006 that we had received a demand from the holder of the $3.0 million convertible secured debenture and that we intended to repay the debenture using available cash which was concluded on August 16, 2006. As the repayment was in response to the debenture holder's demand, 5,454,545 warrants conditionally issued in respect of the debenture are not eligible to be exercised and are considered to have expired. As at December 31, 2006, the $100 convertible debenture remains outstanding, which includes 181,818 warrants conditionally issued in connection with the initial financing and only exercisable if we were to initiate

redemption of the debenture prior to April 1, 2007. As at December 31, 2006, we were in breach of two of the financial covenants in our remaining $100 convertible debenture, for which the holder granted us a waiver. It is our intention to repay this debenture on March 30, 2008 unless the debenture is converted prior to that date. The cure for these financial covenant breaches (which are measured following the completion of our results each quarter) requires us to have positive earnings before interest, taxes, depreciation and amortization. We cannot predict at this time when (if at all) in 2007 we will no longer be in breach of these financial covenants. The holder of the debenture has not demanded repayment of the outstanding principal and accrued interest at this time, however we can not predict whether the holder will do so in the future.

During 2006, 13,275,283 warrants to purchase common shares expired which had exercise prices ranging from $0.50 to $3.60. As at December 31, 2006, there were 3,772,000 warrants outstanding, 1,972,000 ($1.00 exercise price) which expire on April 1, 2007; 1,550,000 ($0.60 exercise price) which expire on June 30, 2007; and 250,000 ($0.60 exercise price) which expire on March 30, 2008.

For 2006, contributed surplus increased from $4,908 to $8,574 predominantly as a result of the inclusion as an equity item the net of the following items: first, an increase of $230 recognized as stock option compensation costs in the consolidated statement of operations; second, an increase of $3,660 as a result of the expiration of common share purchase warrants during 2006 whose value was transferred from the share capital account; and third, a reduction for recognition of the gain on extinguishment of the $3.0 million convertible secured debenture of $224 which was repaid during the third quarter of 2006.

Outstanding Share Data

The following table summarizes the changes in the common shares, common share purchase warrants and options to purchase common shares for the year ended December 31, 2006.

	Common Shares	Warrants	Options
Outstanding at December 31, 2005	52,587,475	17,297,283	5,899,500
Issued / Exercised	390,001	-	(390,001)
Granted	-	-	1,376,875
Cancelled / Expired	-	(13,275,283)	(762,415)
Outstanding at December 31, 2006	**52,977,476**	**3,772,000**	**6,123,959**

As at December 31, 2006, we had 3,772,000 common share purchase warrants outstanding at exercise prices ranging from $0.60 to $1.00 with expiry dates of April 1, 2007, June 30, 2007 and March 30, 2008. There are currently 6,123,959 stock options outstanding at exercise prices ranging from $0.40 to $0.68 with expiry dates from October 2, 2008 through December 28, 2011.

In February and March, 2007, 1,456,121 common share purchase warrants were exercised, to purchase common shares at $0.60 per share. We received proceeds of $874 as a result of this exercise.

In the first half of 2007, 2,065,879 of the remaining 2,315,879 common share purchase warrants will either expire or will be exercised at prices of either $0.60 or $1.00 provided the prevailing market price for our common shares materially exceeds the exercise prices shown, leaving 250,000 outstanding. This excludes the 181,818 common share purchase warrants conditionally issued in respect of the $100 convertible debenture and only exercisable if we were to initiate redemption of the debenture prior to April 1, 2007. Otherwise, the 181,818 conditionally issued common share purchase warrants will also expire by April 1, 2007.

COMMITMENTS AND CONTINGENCIES

In 2005, we acquired an option to purchase a simulation training company (including intellectual property) for a minimum of $800 and secured a license to sell certain of that company's products. The price of the

option was $50 with further amounts payable based on the performance of the company over the next three years. In addition, consideration included our participation in a development project during 2005 at a cost of $447 and $76 in 2006. The option to purchase expires in April of 2008.

As a result of offset commitments from a military contract with a foreign government, we plan to make a one-time investment of $121 in 2007 in a development fund in that country to satisfy this commitment. We may withdraw the market value of our investment in this fund in five years.

As a condition for a license agreement to a Canadian government agency for technology that has been used to help develop our HVT product, we contributed $70 in 2006 to a technology development fund controlled and managed by the Canadian government agency and will pay a variable license fee based on unit sales. Early in 2007, $54 from this fund was authorized for transfer to ourselves as a result of qualifying work performed.

Certain funding from the Canadian Network for the Advancement of Research, Industry and Education Inc. recognized in prior years related to development activities is contingently repayable if the resulting products are commercially successful. Contributions recognized in prior years which may be repayable total $3,749, of which $1,877 may be repayable based on a percentage of sales over an unlimited period and $1,872 may be repayable based on a percentage of sales over a limited period. During 2006 and 2005, no amount was due or repaid. Any subsequent repayments will be recorded as an expense in the period we become liable to make the payments.

In prior years, we had received $355 in funding under an agreement with Technology Partnerships Canada to design, develop and commercialize a Simulation Based Interactive Training System (SBITS). Under the terms of the agreement, we were entitled to receive up to $1,236 as a contribution to certain costs if incurred up to May of 2001 and we are required to pay a royalty based on gross revenues from the commercialization of SBITS to a maximum of $1,858. We are not currently working on the project and do not expect to in the future. Should the project continue, the contributions and the royalties will be recorded in the period we become entitled to the contributions and liable for the royalty payments.

In the normal course of business, we enter into numerous contracts that may contain features that meet the definition of an indemnification and guarantees to counterparties such as: the sale of services or products; the purchase of products and the acquisition of assets or businesses.

In the context of business acquisitions or the purchase of assets, we may, from time to time, agree to compensate the seller for breaches of representations and warranties made about our Company pursuant to an acquisition agreement. These representations and warranties typically relate to the corporate existence, authorization and liquidation as it relates to the purchase, and expire on the completion or closing of the transaction. Historically, there have been no claims under such indemnification agreements.

In the ordinary course of business, we provide indemnification agreements to clients during the sale of services and products. These indemnification agreements require us to compensate the client for costs incurred as a result of litigation claims or damages for intellectual property right infringement and other similar items that may be suffered by the client as a consequence of the agreement. Historically, there have been no claims under such indemnification agreements.

We have entered into operating lease commitments for office space and other leased equipment as follows: 2007 - $1,388; 2008 - $1,044; 2009 - $843; 2010 - $838; 2011 - $829 and thereafter - $1,588 for a total of $6,530.

OFF-BALANCE-SHEET ARRANGEMENTS

In the normal course of business, we may be required to issue letters of credit or performance guarantees. As at December 31, 2006, we had one letter of credit outstanding with a Canadian financial institution in the amount of $2,051 supporting our contract to provide a cockpit procedures trainer to the RDAF via prime contractor AgustaWestland (2005 - nil).

FINANCIAL INSTRUMENTS

We may use foreign exchange forward contracts to manage exposures created when sales and purchases are made in foreign currencies. As at December 31, 2006, there were no foreign exchange forward contracts outstanding (2005 - nil).

We do not use derivative instruments to reduce our exposure to interest rate risk or to change our exposure from fixed to floating interest rates. The interest rate is fixed (at 10%) on the $100 convertible debenture, and the rate floats on the credit facility (which is currently undrawn).

The fair values of all financial assets and liabilities approximate their carrying values as at December 31, 2006.

In 2005, the CICA issued three new accounting standards: Comprehensive Income, Financial Instruments – Recognition and Measurement, and Hedges. These Sections will become effective for the Company on January 1, 2007 and require the following:

a) Section 1530 "Comprehensive Income" – This section describes reporting and disclosure recommendations with respect to comprehensive income and its components. Certain gains and losses arising from changes in fair value will be temporarily recorded outside the statement of operations in comprehensive income.

b) Section 3855 "Financial Instruments – Recognition and Measurement" – This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. All financial instruments including derivatives are to be included in a company's balance sheet and measured either at their fair value or, in limited circumstances, when fair value may not be considered most relevant, at cost or amortized cost. This Section specifies when gains and losses, as a result of changes in fair value, are to be recognized in the statement of operations.

c) Section 3865 "Hedges" – This Section describes when and how hedge accounting can be applied as well as the disclosure requirements.

The Company has not yet determined the impact, if any, of the adoption of these standards on its results from operations or financial position.

RELATED PARTY TRANSACTIONS

In 2006, the following amount was incurred for an entity in which a director of the Company is an owner, partner or principal: $297 (2005 - $372) for legal services. The amount included in accounts payable as due to related parties as at December 31, 2006 was $54 (2005 - $61).

SUBSEQUENT EVENTS

In February and March, 2007, 1,456,121 common share purchase warrants were exercised, to purchase common shares at $0.60 per share. We received proceeds of $874 as a result of these exercises.

CRITICAL ACCOUNTING ESTIMATES

We are required to make estimates and assumptions when accounting for assets and liabilities and when disclosing contingent assets and liabilities at the date of the financial statements and for revenues and expenses for the period reported. We regularly review and change, when necessary, our estimates and assumptions, particularly as they relate to accounting for long-term contracts, stock-based compensation costs, income taxes, deferred development costs and goodwill, based on management's judgment of current conditions and actions that we may undertake in the future. Actual results may differ from estimates previously recorded.

BUSINESS OUTLOOK

The following contains forward-looking statements about our business outlook for 2007. Reference should be made to "Forward-Looking Statements" on page 4. For a description of material factors that could cause our actual results to differ materially from the forward-looking statements in the following, please see the Business Risk Factors section of this MD&A on page 25 and the Description of the Business – Risk Factors section in our Annual Information Form.

We believe that we are well positioned to sustain and improve profitability in future periods. We have established an operating facility in the United States and we are pursuing special security clearance to gain a more competitive foothold in the U.S. military market. We will continue to examine potential acquisitions or mergers that would facilitate our entry into new simulation training sectors and / or geographic markets.

We expect that:

- Approximately one-half (45% to 55%) of our order backlog as at December 31, 2006 of $49.9 million will be realized as revenue in 2007, which includes the $18.4 million in CFTS support services for the twenty-year support period;
- Revenues from the initial contract under the CFTS program in 2007 will decrease versus 2006, however we are pursuing additional opportunities under the CFTS program that may result in marginal additional revenue in 2007;
- The timing and amount of CFTS program revenue to be recognized in 2007 will depend upon:

  – the proportion of work performed in-house;
  – the achievement of milestones by our subcontractors; and
  – changes in the estimated costs to complete the CFTS program;
- CFTS revenue is expected to fluctuate over 2007 and 2008 depending upon the proportion of work performed in-house in any given period and achievement of milestones by our subcontractors on the program;
- We expect ASA to continue to develop and deliver courseware for the CFTS program through 2008;
- The timing and amount of other contract revenue to be recognized in 2007 will depend upon:
  – the proportion of work performed in-house; and
  – changes in the estimated costs to complete the contracts;
- Gross margin percentages in 2007 will continue to fluctuate between 25% and 35% depending on the mix between anticipated CFTS and non-CFTS revenue and the anticipated amount of revenue recognized by ASA, which we expect will initially generate lower margins;
- Combined spending on G&A and S&M at ASI is expected to increase proportionately with anticipated revenue gains in 2007; combined spending at ASA is expected to increase over 2006 reflecting the full-year effect of investment decisions made in 2006 in anticipation of 2007 revenue generation; additional spending on G&A and S&M is expected to occur in 2007 provided ASA is successful in winning new orders (other than as a subcontractor to ASI);
- Interest expense and financing costs will reduce significantly as a result of the recognition of the remaining accretion expense and deferred financing cost amortization related to the Debentures in the second quarter of 2006;
- Depreciation and amortization expense will increase in 2007 versus 2006 due to the level of investment in 2006 and further anticipated investment in 2007;
- We will continue to act as marketing lead for the Allied Wings consortium and will participate in a portion of any revenues arising from this role;

- Cash and cash equivalents are expected to decline as we do not expect the same level of customer deposits through 2007;
- Restricted cash is expected to decline by approximately one half during 2007 as we achieve contract milestones on the RDAF program that trigger the reduction in the value of the letter of credit;
- We will make a one-time investment of $121 in 2007 in a development fund in a country from which we may withdraw the market value of our investment in five years;
- Capital expenditures will remain at approximately 2006 levels; and
- We will make at least one acquisition in 2007, consideration for which may consist of any combination of cash and common shares.

REPORT ON DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for establishing and maintaining the Company's disclosure controls and procedures. They are assisted in this responsibility by the Company's Disclosure Committee, which consists of senior managers of the Company. The Disclosure Committee evaluates material information to determine the appropriateness and timing of its public release. The CEO and CFO have evaluated the effectiveness of the Company's disclosure controls and procedures and have concluded that they were adequate and effective as of December 31, 2006.

The Company maintains internal controls over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with generally accepted accounting principles. The Company's CEO and CFO do not expect that these internal controls will prevent all error and all fraud. Internal controls can only provide reasonable, not absolute, assurance that the objectives of the system are met. Because of inherent limitations, internal controls over financial reporting may not prevent or detect misstatements and fraud. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. Internal controls over financial reporting are based partly on assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

The Company's CEO and CFO have reviewed the design of the Company's internal controls over financial reporting and have concluded that the following condition existed, as at December 31, 2006: Due to the start-up phase of our US operation, segregation of duties are limited, creating the risk of fraud. The Company relies on compensating controls to ensure financial statements are presented fairly, in all material respects.

BUSINESS RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties which are outlined below. These risks are in addition to those outlined elsewhere in this Annual Report and MD&A and in our Annual Information Form.

In order to deliver our commitments under the CFTS program, we will require significant dedicated internal resources, and will be dependent upon the timely delivery of work product from our subcontractors. In addition, as a member of the Allied Wings consortium, we are also dependant on the timely delivery and satisfactory performance of the other partners. Any delay or deferral of resources, deliveries from or disputes with subcontractors or partners could negatively affect our ability to meet milestones and our profit margins relating to CFTS program. Any impairment of the solvency of any of the Allied Wings partners could affect the consortium's ability to meet its obligations under the CFTS program. Non-performance as marketing lead for the Allied Wings consortium could negatively affect our relationship with a significant customer.

Revenue and profitability initially recognized on our long-term contracts depends on reliable cost estimates made in the early stages of such projects. To the extent that there is a significant change in these cost estimates, our revenue and profitability in subsequent periods could change significantly which could, in turn, have an adverse affect on our consolidated results of operations and on our financial condition.

ASA's projected expense levels are based on the assumption that we will win contracts in the U.S. Should we be unable to win contracts and reduce ASA spending accordingly, ASA expense levels will negatively affect our consolidated results of operations and financial condition.

In any one fiscal year, we have typically derived a substantial portion of our revenues from a small number of contracts with major customers. Historically, one customer in particular has represented a substantial portion of our revenues. The composition of this group of major customers may change from year to year and our revenues and profitability are dependent upon our ability to win key contracts from such major customers.

To the extent that sufficient identified market and forecasted sales of the HVT product do not materialize, we may be required to write down the carrying value of this initiative.

To the extent that prospects for profitability and operating cash flows are not realized, we will face a possible impairment to the carrying value of our goodwill, requiring a charge to be taken against our operating results.

We may pursue acquisitions in order to complement or expand our business. The negotiation of potential acquisitions could divert our time and resources and require funds to consummate. The process of combining with another company could be disruptive to our business and could result in unforeseen operating difficulties requiring financial resources. Further, we may finance future acquisitions through borrowings or otherwise incur indebtedness in connection with acquisitions. In addition, if we consummate one or more acquisitions through the issuance of common shares, holders of common shares could suffer dilution of their ownership interests.

We are subject to laws, regulations and standards relating to corporate governance and public disclosure in Canada. Our efforts to comply with such requirements have resulted in, and are likely to continue resulting in, increased general and administrative expenses and diversion of management time and attention from revenue-generating activities to compliance activities. In particular, we are in the process of assessing our internal control over financial reporting with a view to being able to conduct an evaluation when requirements to do so are imposed by Canadian securities regulators in the future. Our assessment of our internal control over financial reporting may bring to light weaknesses in internal control over financial reporting. For example, in assessing ASA, we have identified that proper segregation of duties does not exist due to its start-up nature. To the extent that we identify internal control weaknesses that require correction, we may be required to incur expenditures or costs, which, if significant, could adversely affect our operating results.

Our future is dependent on management's ability to leverage its extensive engineering background and differentiate itself as a supplier for cost-effective, next generation training solutions. Implementation of this strategy is dependent on management's ability to secure sufficient working capital financing and on the timely award of targeted contracts.

To the extent that we act as the prime contractor for military contracts that depend on private funding, failure to raise the required financing would have an effect on our ability to perform and on our reputation.

Certain opportunities in the United States will require continued business relationships with our partners who are prime contractors for U.S. military procurements. If we are unable to maintain and develop these relationships, business opportunities in the United States may be limited which could, in turn, have an adverse affect on our consolidated results of operations and on our financial condition.

As a condition of dispositions, teaming agreements and in the normal course of our business, we enter into non-compete, non-disclosure, and other similar commitments. Non-performance on these commitments could negatively affect future results.

Our historical operating results reflect substantial benefits from programs sponsored by the Canadian government to support businesses like ours. If changes in law or government policies regarding these programs were to result in their termination or adverse modification, or if we were to become unable to participate in, or take advantage of these programs, the cost of our operations could materially increase and there could be an adverse effect on our results.

Our business relies heavily on government military program expenditure. To the extent that funding of military programs declines, we may experience reductions in future revenues.

The markets for our current and planned products and services are characterized by rapid technological advances, competing technological platforms, emerging and evolving industry standards, changes in customer requirements and frequent new product introductions and enhancements. Our future success will depend upon our ability to enhance our current products and services, develop and introduce new products and services that keep pace with technological developments, respond to evolving customer requirements, meet the technical requirements of our strategic partners and achieve market acceptance for our products.

We rely on technological competence to provide value to our customers. In an environment of rapid technological change, ownership of any particular technology cannot guarantee market position. To the extent that we are unable to sustain our technological competitiveness, we may be less successful in achieving future contract awards.

We rely in part on trade secrets and contractual arrangements, such as confidentiality and non-disclosure agreements, to establish and protect our technology. Such reliance may be insufficient to prevent misappropriation of our technology or to deter others from developing similar technologies. Enforcement of our intellectual property rights or our ability to acquire such rights may be unavailable or limited. In addition, infringement claims may be brought against us or our customers in the future. We may not be successful in the defence of such claims and may not be able to develop processes that do not infringe on the rights of third parties or obtain licenses on commercially acceptable terms, if at all.

Fluctuations in the value of the Canadian dollar relative to foreign currencies (particularly the U.S. dollar), could result in exchange gains and losses or increased costs.

Our performance depends on our ability to attract and retain personnel with appropriate technical, administrative and program-related skills and experience. To the extent that we are unable to attract and retain such personnel, our competitiveness could be adversely affected.

The markets in which we operate are highly competitive. Competition may prevent us from winning significant contracts and may prevent us from realizing historically typical levels of profitability. Any such effects would negatively affect our consolidated results of operations and financial condition.

The nature of our business involves lengthy sales cycles and regular delays over which we have no control. Any ongoing failure to achieve such sales could have a material adverse effect on our business, financial condition and the results of our operations. Furthermore, maintenance of our key partnerships as our sales strategies evolve is essential.

Additional information about us can be found in our Annual Information Form and in our Management Information Circular, both of which are available on SEDAR at www.sedar.com.

March 30, 2007

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The preparation of the consolidated financial statements of Atlantis Systems Corp. is the responsibility of Management. This responsibility includes the selection of appropriate accounting policies and the exercise of careful judgement in establishing reasonable and accurate estimates in accordance with accounting principles generally accepted in Canada applied on a consistent basis and as appropriate in the circumstances. Financial information shown elsewhere in this Annual Report is consistent with that contained in the consolidated financial statements.

Management of Atlantis Systems Corp. and its operating divisions has developed and maintains accounting systems and internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorised use and that the financial records are reliable.

The Board of Directors approves these consolidated financial statements and carries out its responsibility in this regard principally through the Audit Committee of the Board. The Audit Committee reviews the results of audit examinations performed by the independent external auditors with respect to Atlantis Systems Corp.'s accounting principles, practices and systems of internal control.

The consolidated financial statements have been audited by Deloitte & Touche, LLP, Chartered Accountants. Their report stating the scope of their audit and their opinion on the consolidated financial statements is presented on the following page.

Andrew Day

President and Chief Executive Officer

John F. Kalas

Senior Vice President and Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of

Atlantis Systems Corp.

We have audited the consolidated balance sheets of Atlantis Systems Corp. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and of cash flows for the years then ended. 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 Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Licensed Public Accountants

Toronto, Ontario

March 30, 2007

CONSOLIDATED BALANCE SHEETS

AS AT DECEMBER 31, 2006 AND 2005

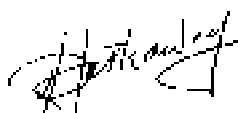
(Expressed in thousands of Canadian dollars)

	2006	2005
		(Restated - Note 2)
ASSETS		
Current assets		
Cash and cash equivalent	**$ 13,636**	$ 8,755
Trade and other receivables *(Note 4)*	**6,459**	8,374
Unbilled revenue	**524**	3,501
Inventory *(Note 5)*	**427**	352
	21,046	20,982
Restricted cash *(Note 11)*	**2,051**	-
Capital assets, net *(Note 6)*	**1,747**	886
Other long-term assets	**111**	117
Mortgage receivable *(Note 7)*	**384**	370
Deferred development costs *(Note 8)*	**1,669**	1,542
Deferred financing costs	**-**	223
Goodwill	**11,735**	11,735
	17,697	14,873
	$ 38,743	$ 35,855
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**$ 7,024**	$ 5,103
Accrued costs on percentage completion	**444**	107
Deferred revenue	**9,452**	5,686
Convertible debenture *(Note 9)*	**100**	-
	17,020	10,896
Convertible debentures *(Note 9)*	**-**	2,035
	17,020	12,931
COMMITMENTS, CONTINGENCIES AND GUARANTEES *(Note 18)*		
SHAREHOLDERS' EQUITY		
Share capital *(Note 12)*	**88,080**	91,512
Contributed surplus	**8,574**	4,908
Deficit	**(74,931)**	(73,496)
	21,723	22,924
	$ 38,743	$ 35,855

ON BEHALF OF THE BOARD:

Henry Pankratz

Director



Donald B. Hathaway

Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(Expressed in thousands of Canadian dollars except per share amounts)

	2006	2005
		(Restated - Note 2)
Revenue *(Notes 4 and 16)*	**$ 37,115**	$ 32,937
Cost of revenue *(Notes 13)*	**26,252**	23,429
Gross margin	**10,863**	9,508
Expenses *(Notes 17)*		
General and administrative	**7,504**	3,580
Selling and marketing	**3,239**	2,066
Stock options	**230**	725
	10,973	6,371
Operating (loss) income before the undernoted items	**(110)**	3,137
Depreciation and amortization	**446**	190
Interest and financing costs, net *(Note 10)*	**1,103**	529
Other expenses *(Note 16)*	**-**	714
Gain on extinguishment of debenture *(Note 9)*	**(224)**	-
Net (loss) income	**(1,435)**	1,704
Deficit, beginning of year	**(73,496)**	(75,200)
Deficit, end of year	**$ (74,931)**	$ (73,496)
Net (loss) income per share *(Note 15)*		
Basic	**$ (0.03)**	$ 0.03
Diluted	**$ (0.03)**	$ 0.03
Weighted average number of shares		
Basic	**52,791,645**	49,570,595
Diluted	**52,791,645**	51,519,759

The accompanying notes are an integral part of these consolidated statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

(Expressed in thousands of Canadian dollars)

	2006	2005
		(Restated - Note 2)
Cash flows provided by (used in):		
Operating activities:		
Net (loss) income	**$ (1,435)**	$ 1,704
Items not affecting cash:		
Depreciation and amortization	**446**	190
Stock options expensed	**230**	725
Accretion of debentures *(Note 9)*	**1,065**	220
Amortization of deferred financing costs	**286**	46
Gain on extinguishment of debenture *(Note 9)*	**(224)**	-
	368	2,885
Interest on mortgage receivable	**(14)**	(12)
Deferred development costs	**(127)**	(1,542)
Other long-term assets	**6**	(117)
Net change in non-cash working capital *(Note 20)*	**10,800**	2,193
	11,033	3,407
Investing Activities:		
Investment in capital assets	**(1,266)**	(637)
Restricted cash	**(2,051)**	-
	(3,317)	(637)
Financing Activities:		
Common share issuance	**-**	2,040
Share issuance costs	**-**	(113)
Exercise of common share purchase warrants	**-**	1,734
Exercise of options to purchase common shares	**165**	239
(Repayment) issuance of convertible debenture	**(3,000)**	3,100
Debenture financing costs	**-**	(398)
Repayment of promissory notes	**-**	(986)
	(2,835)	5,616
Net increase in cash and cash equivalents	**4,881**	8,386
Cash and cash equivalents, beginning of year	**8,755**	369
Cash and cash equivalents, end of year	$ 13,636	$ 8,755
SUPPLEMENTAL INFORMATION		
Cash and cash equivalents are comprised of:		
Cash	**13,606**	8,707
Cash equivalents	**30**	48
	13,636	8,755
Interest paid	**$ 203**	$ 497
Income taxes paid	**$ -**	$ -

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

EXPRESSED IN THOUSANDS OF DOLLARS EXCEPT PER SHARE AMOUNTS, UNLESS OTHERWISE INDICATED

1. NATURE OF OPERATIONS

Atlantis Systems Corp. (the "Company") continued under the laws of Canada and is listed on the Toronto Stock Exchange (TSX-AIQ). Atlantis Systems International Inc. ("ASI") and Atlantis Systems America Inc. ("ASA") are operating subsidiaries of the Company. ASI is a training integrator specializing in military, commercial aviation and energy markets worldwide. ASI combines desktop and full-flight simulation, knowledge management, learning management systems and multimedia courseware to provide integrated training systems to customers in the military, commercial aviation and energy markets. ASA has been established to provide similar services in the United States. In addition, the Company has an 85% interest in Denbridge Digital Limited, which is an inactive holding company.

2. RESTATEMENT OF PRIOR YEAR FINANCIAL STATEMENTS

The Company has reviewed its revenue recognition for contracts with multiple deliverables and has determined that the recognition of revenue for the year ended December 31, 2005 was incorrect. The restatement required to correct this error is a reduction in revenue and cost of revenue of $697 and $483, respectively. As at December 31, 2005, deferred revenue increased by $697 and accrued costs on percentage completion decreased by $483. The correction of this error decreased the basic and diluted net income per share for 2005 by $0.01 per share to $0.03 per share. The restatement does not impact periods prior to January 1, 2005.

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). The significant accounting policies are as follows:

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Revenue recognition

Revenue from long-term contracts for developing, building and supporting simulators and training systems is recognized using the percentage of completion method where revenue is recorded as labour costs are incurred, based on actual labour costs incurred to date on a contract, relative to the estimated total labour costs to complete the contract. When subcontractor or material costs form a significant portion of total costs, revenue is recognized as costs are incurred based on labour, material and actual sub-contract costs incurred to date on a contract, relative to the estimated total labour, material and sub-contract costs to complete the contract. In the event that the Company has large contracts where it can segment costs into separate sub-components, revenue is to be recognized as each sub-component progresses to completion. All other revenues and related costs are recorded at the time the services are performed or the product is delivered. Full provision is made for any anticipated losses in the period in which the relevant facts become known.

Unbilled revenue represents revenue earned in excess of amounts billed on uncompleted contracts. Deferred revenue represents the extent that billings to clients are in excess of revenue recognized to date. The results reported under the percentage of completion method are based on the Company's estimates of total labour and sub-contract costs to complete the various contracts. Should total actual labour or sub-contract costs be materially higher or lower than these estimates, adjustment to future results would be necessary.

Disputes arise in the normal course of the Company's business on projects where the Company contests with customers or owners for additional funds because of events such as delays or changes in contract specifications. Such disputes, whether claims or unapproved changes in process of negotiation, are recorded at the lesser of their estimated value or actual costs incurred and only when realization is certain. Claims against the Company are recognized when the loss is considered probable and reasonably determinable.

The Company follows the accounting recommendations of Emerging Issues Committee ("EIC") EIC-141 "Revenue Recognition", EIC-142, "Revenue Arrangements with Multiple Deliverables" and EIC-143, "Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts". EIC-141 summarizes the principles set as interpretive guidance on the application of CICA Handbook section 3400, "Revenue". Specifically this EIC presents the criteria to be met for revenue recognition to be considered achieved. EIC-142 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue generating activities for a given customer. Finally, EIC-143 considers the issue of how revenue and costs from separately priced extended warranty or product maintenance contracts should be recognized. The Company currently has contracts that include multiple deliverables as defined in EIC-142. For each of these contracts, the delivered item does not qualify as a separate unit of accounting. As a result, the consideration allocable to the delivered item is combined with the consideration allocable to the undelivered item and revenue recognition is determined on the combined deliverables as a single unit of accounting.

Deferred financing costs

Deferred financing costs represent fees and costs in connection with the issuance of the convertible debentures. The Company's policy is to amortize these costs over the term of the debentures.

Research and development costs

Research costs, net of related investment tax credits, are expensed as incurred. Development costs, net of related investment tax credits, are expensed as incurred unless such costs meet the criteria for deferral and amortization under Canadian GAAP.

Deferred development costs

The Company's policy is to expense development costs unless they meet generally accepted criteria for capitalization. These criteria include whether the product is clearly defined, attributable costs can be identified, technical feasibility has been established, the market for the product has been clearly defined and management intends to pursue that market and sufficient resources exist to complete the project. Upon commercial launch of the product, these costs are to be amortized over the number of unit sales, over a period not to exceed forty-eight months. The Company assesses the recoverability of the capitalized costs by determining whether the unamortized balance can be recovered through undiscounted projected future net cash flows of the related products. The benefits of investment tax credits are recognized as a reduction of development expenditures in the period the qualifying expenditures are incurred if there is reasonable assurance the tax credits will be realized.

Derivative financial instruments

The Company follows CICA Accounting Guideline 13—Hedging Relationships (AcG-13) and CICA Abstract EIC-128, Accounting for Trading, Speculative or Non-hedging Derivative Financial Instruments (EIC-128). AcG-13 specifies the circumstances in which hedge accounting is appropriate, including the identification, documentation, designation, and effectiveness of hedges and the discontinuance of hedge accounting. EIC-128 requires that derivatives that do not qualify for hedge accounting are carried at fair value on the balance sheet and changes in fair value are recorded in the statement of operations.

The Company did not enter into any hedging relationships during fiscal 2006 and fiscal 2005.

From time to time, the Company utilizes derivatives on a basis consistent with the risk management policies of the Company and these derivatives are monitored by the Company for effectiveness as economic hedges even if the specific hedge accounting requirements of AcG-13 are not met.

Foreign currency translation

The Company's foreign subsidiary is considered to be an integrated operation and its accounts are translated into Canadian dollars using the temporal method. The temporal method is also applied to monetary assets and liabilities of the Company, as well as revenue and expenses, which are denominated in foreign currencies. Under this method, monetary items are translated at the rate of exchange at the balance sheet dates, non-monetary items are translated at historical exchange rates and revenues and expenses are translated at the average exchange rate for the year. Amortization of non-monetary assets is translated at the same exchange rate as the assets to which they relate. Exchange gains or losses on translation are included in the determination of the net income for the year.

From time to time, the Company enters into forward foreign exchange contracts to manage exposures resulting from foreign exchange fluctuations in the ordinary course of business. Gains and losses on these contracts are deferred and accounted for as part of the transactions being hedged, when the criteria established by AcG-13 are met. The Company negotiates forward contracts only with financially sound counter parties. During the years ended December 31, 2006 and 2005, the Company did not enter into any forward contracts and did not have any contracts outstanding.

Cash and cash equivalents

Cash and cash equivalents include deposits and other highly liquid financial instruments all having a maturity of 90 days or less at the date of purchase.

Inventory

Inventory of finished goods, work-in-process, and raw materials are recorded at the lower of cost, determined on a first-in, first-out basis, and net realizable value. The cost of work in process includes material, labour, and an allocation of manufacturing overhead.

Capital assets

Capital assets are recorded at cost, net of any investment tax credits, and are amortized on a straight-line and declining balance basis over the estimated useful lives of the related assets, at annual rates between 20% and 30%.

Asset retirement obligations

Liabilities for asset retirement obligations are recorded at fair value in the period in which the liability is incurred. When the fair value of the liability is initially recorded, a corresponding increase to the carrying amount of the related asset is also recorded and depreciated over the useful life of the asset. Over time, the liability is increased to reflect the interest element (accretion) considered in its initial measurement at fair value.

Impairment of long lived assets

Long lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. An impairment loss is recognized when the carrying amount of a long lived asset is not recoverable and exceeds its fair value.

Goodwill

Goodwill represents the excess of the purchase price paid to acquire all of the shares of ASI over the fair value of its underlying net identifiable assets. Goodwill is not amortized. The Company reviews the valuation of goodwill on an annual basis or when an event or circumstance occurs which more likely than not reduces the fair value of a reporting unit below its carrying amount. In doing so, the Company evaluates whether there has been an impairment in the value of goodwill based on a comparison of the fair value of the reporting unit to the underlying carrying value of the reporting unit's net assets, including goodwill. Discounted cash flows are used to determine the fair value of the reporting unit.

Stock-based compensation plans

The Company has a stock-based compensation plan for directors, officers, employees and consultants, which is described in note 12. All stock options granted under the plan have an exercise price not less than the market price of the shares on the date the option is granted. Effective January 1, 2003, the Company adopted on a prospective basis the fair-value method of accounting for stock-based compensation awards granted to employees for options granted on or after that date. Under this policy, the Company determines the fair value of the stock options on their grant date and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these options are exercised, the amount of proceeds, together with the amount recorded in contributed surplus are recorded in share capital. The fair value of these options are determined using the Black-Scholes option pricing model.

During 2006, the Company adopted Emerging Issues Committee EIC-162, "Stock–Based Compensation for Employees Eligible to Retire Before The Vesting Date". Under EIC-162, compensation costs attributable to a stock-based award for a compensation plan that contains provisions that allow an employee to continue vesting in accordance with the stated vesting terms after the employee has retired from the entity, should be recognized on the grant date where an employee is eligible to retire at the grant date or should be recognized over the period from the grant date to the date the employee becomes eligible to retire where an employee will become eligible to retire during the vesting period. The application of EIC-162 had no impact on the Company's consolidated financial statements.

Income taxes

The Company uses the asset and liability method for accounting for income taxes. Under this method, temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. The effect of the change in income tax rates on recognized future income tax liabilities or assets is recognized in income in the period that the change occurs. Future income tax assets are evaluated annually and if realization is not considered more likely than not, the value of the recognized future tax asset is adjusted by a charge to income.

Use of estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions. These estimates affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates used in the financial statements include the following: revenue recognition and estimated costs to complete for percentage of completion basis on long-term contracts; allowance for doubtful accounts and inventory reserves; valuation of goodwill and long-lived assets; provision for product warranties and estimates used in the valuation of stock options. Actual results could differ from those estimates.

Earnings per share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the year. Diluted earnings per share is computed using the weighted average number of common and potential common shares outstanding during the year. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options and share purchase warrants and the conversion of convertible debentures that are dilutive to the earnings per share calculation. The weighted average number of potential common shares issuable upon the exercise of stock options and share purchase warrants is calculated using the treasury stock method. The weighted average number of potential common shares issuable upon the conversion of convertible debentures is calculated using the "if-converted" method.

Variable interest entities

During 2005, the Company adopted Accounting Guidelines 15 ("AcG-15"), Consolidation of Variable Interest Entities ("VIEs"). AcG-15 provides criteria for the identification of VIEs and further criteria for determining what entity, if any, should consolidate them. AcG-15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the equity investors lack the characteristics of a controlling financial interest. VIEs are subject to consolidation by the Company if it is deemed the primary beneficiary of the VIE. The primary beneficiary is the party that is either exposed to a majority of the expected losses from the VIE activities or is entitled to receive a majority of the VIE residual returns or both. The Company has determined that it is not the primary beneficiary of any VIE.

4. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers; however, as at December 31, 2006 one customer represented 77% of the accounts receivable and unbilled revenue (2005 - 46%) and during the year, represented 77% of revenues (2005 - 56%).

5. INVENTORY

	2006	2005
Raw materials	**$ 304**	$ 249
Work-in-process	**71**	64
Finished goods	**52**	39
	$ 427	$ 352

6. CAPITAL ASSETS

Capital assets consist of the following:

	2006		
	Cost	**Accumulated Depreciation and Amortization**	**Net Book Value**
Equipment, software, furniture and fixtures	**$ 2,610**	**$ 1,266**	**$ 1,344**
Leasehold improvements	**638**	**235**	**403**
	$ 3,248	**$ 1,501**	**$ 1,747**

	2005		
	Cost	Accumulated Depreciation and Amortization	Net Book Value
Equipment, software, furniture and fixtures	$ 1,466	$ 935	$ 531
Leasehold improvements	477	122	355
	$ 1,943	$ 1,057	$ 886

7. MORTGAGE RECEIVABLE

The mortgage receivable earns interest monthly at 4.5% per annum and requires principal payments of $250 on December 1, 2008 and $200 on December 1, 2013. These amounts are discounted at a rate of 9%. If the Company defaults on the payment of the premises rent, the mortgage receivable will be null and void.

8. DEFERRED DEVELOPMENT COSTS

In 2006, the Company continued to fund a specific development project focused on the Helicopter Vocational Trainer (HVT) concept. As a result, development costs of $127 have been capitalized in 2006 (2005 - $1,542). The development project is expected to be completed in early 2007 and there are sufficient identified markets and forecasted sales of the HVT product to recover the costs capitalized and generate profits. No amortization has been recorded to date.

9. CONVERTIBLE DEBENTURES

On April 4, 2005, the Company issued two debentures (the "Debentures") maturing March 30, 2008 in the principal amount of $3,100. The first debenture in the amount of $3,000 is a 10% convertible secured debenture and is convertible, at the holder's option, at any time prior to March 30, 2008 into 5,454,545 common shares of the Company at a conversion price of $0.55 per share. The second debenture in the amount of $100 is a 10% convertible unsecured debenture and is convertible, at the holder's option, at any time prior to March 30, 2008 into 181,818 common shares of the Company at a conversion price of $0.55 per share.

The Company had the right to redeem these debentures within the first twenty four months of issuance at par without premium or penalty.

In connection with these transactions, the Company issued common share purchase warrants to the holders of the Debentures to purchase 5,636,363 common shares at a price of $0.60 per common share. The purchase warrants were exercisable only if the Debentures are redeemed by the Company within the twenty four month period. The Company issued common share purchase warrants to purchase 250,000 common shares at a price of $0.60 per common share as part of the compensation to the broker. The broker warrants expire March 30, 2008.

In addition, the Company has the right to convert the principal amount of the Debentures into common shares at $0.55 per share if the trading price of the Company's common shares closes at or above $1.50 for at least 90 consecutive trading days.

The terms of the Debentures provide for events of default which, among others, include failure to make payments under the indebtedness when due, failure to achieve $2,000 of earnings before interest, taxes, depreciation and amortization, and failure to maintain a positive working capital of $1,000 and a working capital ratio of at least 1.3:1. In such event, all principal and interest is due and payable.

The legal form of the Debentures is debt; however, because of the conversion feature, the Company secured an interest rate that was lower than the estimated fair value interest rate for similar debentures without a conversion feature. The liability component of the Debentures represents the present value of the future principal due under the terms of the Debentures. Using the Black-Scholes model and based upon a risk free interest rate of 3.5%, stock volatility of 53%, the market price at date of issuance of $0.63 and a conversion price of $0.55, the value of the equity portion of the financial instrument is $0.23 per share or $1,285. The principal amount of the Debentures was allocated between debt and contributed surplus at $1,815 and $1,285, respectively. The estimated interest rate of the debt portion of the Debentures is approximately 18%.

On June 30, 2006, the Company was in breach of one of the convertible debenture covenants. As a result, the entire amount of the Debentures were reported as current liabilities at June 30, 2006 and included the fully accreted amount of debt. Related to the reclassification of the Debentures, interest expense included additional amortization expense of $176 to fully amortize the deferred financing costs associated with the debentures. Year to date accretion at June 30, 2006, included in interest expense, amounted to $1,065. No accretion was required subsequent to June 30, 2006.

On August 16, 2006, the Company repaid the principal and interest owed on the $3,000 debenture, as a result of receiving from the debenture holder a demand for repayment. In management's opinion, as the repayment was in response to the debenture holder's demand, warrants conditionally issued in respect of the debenture are not eligible to be exercised and are considered to have expired. The consideration paid to the debenture holder has been allocated to the liability and equity elements of the security on a basis consistent with the original allocation. The equity component was re-valued on the date of extinguishment using the Black-Scholes model and based upon a risk free interest rate of 3.9%, stock volatility of 53%, the market price at the date of extinguishment of $0.33 and a conversion price of $0.55. This resulted in a gain on extinguishment of $224 being recognized for the year ended December 31,2006. As at December 31, 2006, the $100 debenture remains outstanding. The Company continues to be in breach of two of the convertible covenants on the debenture that remains outstanding.

10. INTEREST AND FINANCING COSTS, NET

	2006	2005
Interest expense	**$ 1,508**	$ 539
Finance and bank charges	**153**	128
Interest income	**(558)**	(138)
Total	**$ 1,103**	$ 529

11. OPERATING LINE OF CREDIT AND RESTRICTED CASH

At December 31, 2006 and 2005, the Company had no bank indebtedness.

The Company has available a general operating line of credit in the amount of $5,000. The line of credit bears interest at the bank's prime lending rate plus 0.75%. The line of credit is collateralized by a general security agreement over all present and future personal property.

In July 2006, as a condition of a new contract to provide a cockpit procedures trainer, the Company entered into a letter of credit with a Canadian financial institution in the amount of $2,051. The letter of credit has been fully collateralized by the Company restricting the use of an equal amount of its cash on hand with the counterparty to the letter of credit. The value of this letter of credit and the amount of restricted cash will decline as the contract milestones are achieved through June 2008.

12. SHARE CAPITAL

Authorized:

An unlimited number of common shares; and an unlimited number of special shares issuable in series.

Issued:

	2006		2005	
	Number	**Stated Capital**	Number	Stated Capital
COMMON SHARES				Opening
Opening balance	**52,587,475**	**$ 87,503**	45,151,225	$ 83,583
April, 2005 equity financing (net of issuance costs of $113 - *note (a)*)	-	-	3,400,000	1,721
Warrants exercised *(note (a))*	-	-	3,467,500	1,870
Options exercised *(note (b))*	**390,001**	**228**	568,750	329
Closing balance	**52,977,476**	**87,731**	52,587,475	87,503
WARRANTS				
Opening balance	**17,047,283**	**4,009**	18,542,783	3,939
April, 2005 equity financing *(note (a))*	-	-	1,972,000	206
Warrants expired *(note (d))*	**(13,275,283)**	**(3,660)**	-	-
Warrants exercised *(note (a))*	-	-	(3,467,500)	(136)
Closing balance	**3,772,000**	**349**	17,047,283	4,009
Share capital, closing balance		**$ 88,080**		$ 91,512

a. On April 1, 2005, the Company completed an equity financing in the amount of $2,040. The equity financing resulted in the issuance of 3,400,000 common shares and 1,700,000 common share purchase warrants which entitle the holder to acquire one common share upon payment of $0.80 per share between April 1, 2005 and October 1, 2005 and $1.00 per share between October 2, 2005 to April 1, 2007. In addition, the Company issued 272,000 broker warrants which entitle the holder to acquire one common share upon payment of $0.80 per share between April 1, 2005 and October 1, 2005 and $1.00 per share between October 2, 2005 to April 1, 2007. The fair value of each warrant is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions used for the grants: dividend yield 0%, expected volatility 53%, risk free interest rate 3.5%. The value assigned to these warrants is $206. During 2005, 3,467,500 common share purchase warrants were exercised at $0.50 per common share resulting in new equity in the amount of $1,734.

b. For the full year 2006, 390,001 stock options (2005 - 568,750) were exercised for proceeds of $165 (2005 - $239) resulting in additional share capital in the amount of $228 (2005 - $329). Also in 2006, there were 762,415 stock options (2005 - 447,250) that either expired or were cancelled.

c. The Company has an incentive stock option plan (the "Plan") pursuant to which it may grant options to purchase the Company's shares to directors, officers, employees, and consultants. Compensation expense is recognized when the options are issued over the vesting period (Note 3).

   The following chart summarizes the changes in the options granted under the Plan:

	Number	Weighted-Average Exercise Price
Balance, December 31, 2004	667,500	$ 1.43
Granted	6,248,000	$ 0.43
Cancelled or expired	(447,250)	$ 0.63
Exercised	(568,750)	$ 0.42
Balance, December 31, 2005	5,899,500	$ 0.53
Granted	1,376,875	$ 0.60
Cancelled or expired	(762,415)	$ 1.20
Exercised	(390,001)	$ 0.42
Balance, December 31, 2006	6,123,959	$ 0.47

   The following table summarizes stock option information outstanding at December 31, 2006:

Exercise Prices of Options	Number Outstanding	Exercisable (Vested)	Remaining Contractual Life	Weighted-Average Exercise Price
$0.40 - $0.45	4,411,584	3,856,121	3.02 yrs	$ 0.42
$0.55	516,875	102,231	4.99 yrs	$ 0.55
$0.60 - $0.68	1,195,500	323,501	3.97 yrs	$ 0.63
$0.40 - $0.68	6,123,959	4,281,853	3.33 yrs	$ 0.47

In 2006, the Company's Board of Directors awarded to employees and directors a total of 1,376,875 (2005 - 6,248,000) options to buy shares of the Company under the plan. These options carry a term of five years, exercise prices ranging from $0.45 to $ 0.68 (2005 - $0.42 - $0.62), and various vesting terms.

The estimated fair value of the options is amortized to income over the vesting period, on a straight-line basis, and was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005
Risk-free rate	**3.9% - 3.95%**	3.5% - 3.8%
Dividend yield	**0%**	0%
Volatility factor of expected market price of the Company's shares	**53% and 48%**	53%
Expected option life (in years)	**3**	3
Weighted-average grant date fair values of options granted	**$0.23**	$0.17

For the year ended December 31, 2006, 516,875 of the options granted were valued based on a volatility factor of 48%. The remaining 860,000 options granted in the year were valued using a volatility factor of 53%.

For the year ended December 31, 2006, the Company expensed $230 (2005 - $725) relating to the fair value of options granted and is reflected in the Consolidated Statements of Operations and Deficit.

As at December 31, 2006, there remained available for issuance under the Plan, 1,822,662 (2005 - 31,750) options to acquire common shares of the Company. Under the Plan, the vesting of options can vary from grant to grant, at the discretion of the Board of Directors. The exercise price of each option must not be less than the closing market price of the Company's common shares on the Toronto Stock Exchange on the day prior to the date of grant. The options available for issuance under the Plan are not adjusted as options are exercised. The total proceeds that would be generated upon exercise of all issued and outstanding options is approximately $2,890.

d. The breakdown of warrants outstanding at December 31, 2006 is as follows:

Expiry Date	Number of Warrants	Exercise Price
April 1, 2007	1,972,000	$ 1.00
June 30, 2007	1,550,000	0.60
March 30, 2008	250,000	0.60
	3,772,000	$ 0.81

During the year ended December 31, 2006, 13,275,283 warrants expired.

This breakdown of warrants outstanding at December 31, 2006 excludes the 181,818 common share purchase warrants (at an exercise price of $0.60) issued to the holder of the Debenture which only become exercisable if the Company redeems the Debenture prior to April 1, 2007. If redeemed, these common share purchase warrants expire twenty-four months following redemption.

13. RESEARCH AND DEVELOPMENT

Research and development expenditures included in cost of revenue for the year ended December 31, 2006 were $76 (2005 - $447).

14. INCOME TAXES

The provision for income taxes reflects an effective tax rate that differs from the statutory tax rate for the following reasons:

	2006	2005
Statutory rate	**36%**	36%
Non-deductible amounts	**(26)%**	15%
Temporary differences	**(23)%**	(30)%
Impact of lower US statutory rate	**4%**	-
Utilization of tax loss carryforwards	**9%**	(21)%
	-	-

The Company has unutilized Canadian non-capital tax loss carry forwards of $13,810 (2005 - $19,130) that are available for carry forward against taxable income in future years. These tax losses expire in various years beginning in 2007 through 2015.

The Company has unutilized U.S. non-capital tax loss carry forwards of $3,135 (2005 - $Nil) that are available for carry forward against taxable income in future years. These tax losses expire in 2026.

The Company's future income tax assets comprise the following:

	2006	2005
Future income tax asset resulting from operating loss carry forwards	**$ 6,069**	$ 6,976
Future income tax asset resulting from capital tax loss carry forwards	**1,220**	1,220
Future income tax liability resulting from temporary differences and other items	**(1,426)**	(1,811)
	$ 5,863	$ 6,385
Less valuation allowance	**(5,863)**	(6,385)
Future income tax asset	**$ -**	$ -

15. NET (LOSS) INCOME PER SHARE

Basic earnings per share figures are calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the dilution that would occur if outstanding stock options, share purchase warrants and convertible debentures were exercised or converted into common shares using the treasury stock method.

The treasury method of calculating the diluted earnings per share requires that only those of the Company's stock options and share purchase warrants and convertible debentures whose exercise prices are lower than the average share prices for the relevant periods be used in the calculation of dilution.

The weighted average number of shares outstanding used in the calculation of basic earnings per share for the year ended December 31, 2006 was 52,791,645 (2005 - 49,570,595).

The weighted average number of shares outstanding used in the calculation of the diluted earnings per share using the treasury stock method for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005
Weighted average common shares outstanding	**52,791,645**	49,570,595
Weighted average potential common shares		
Share purchase warrants	-	510,469
Stock options	-	1,438,695
	52,791,645	51,519,759

In 2006, the inclusion of the Company's stock options and share purchase warrants in the computation of diluted loss per share had an anti-dilutive effect on earnings per share and, therefore, were excluded from the computation. Conversion of the convertible debenture(s) in 2006 and 2005, using the "if-converted" method, had an anti-dilutive effect on earnings per share and, therefore, was (were) excluded from the computation.

16. CONTINGENT LIABILITY AND ADDITIONAL REVENUE

In fiscal 2003, as part of an assignment of an in-progress contract to a third party, the Company assumed a contingent liability, which would have become payable in the event that a related termination fee against the ultimate contract owner was not paid. In 2005, the Company recognized an expense of $714 related to this contingent liability which was included in other expenses.

In 2005, the Company recognized $924 of additional revenue related to the termination of a contract by a customer.

17. GEOGRAPHIC INFORMATION

	Revenue		**Capital Assets & Goodwill**	
	2006	2005	**2006**	2005
Canada	**$ 30,876**	$ 19,431	**$ 13,129**	$ 12,621
International	**6,239**	13,506	**353**	-
	$ 37,115	$ 32,937	**$ 13,482**	$ 12,621

The allocation of revenues to the geographic segments is based upon the location of the customer.

The Company's subsidiary, ASA, has incurred expenses prior to the commencement of commercial operations. Costs incurred prior to the commencement of commercial operations are charged as an expense in the period in which they are incurred. In 2006, the Company incurred operating expenses of $3,241 (2005 - $189).

18. COMMITMENTS, CONTINGENCIES AND GUARANTEES

a. In 2004, the Company entered into a ten year license agreement with a Canadian Crown Corporation (the "Crown") whereby the Company will commercialize a product developed by the Crown and will pay a variable license fee based on unit sales of the development product.

b. Certain funding from Canadian Network for the Advancement of Research, Industry and Education Inc. recognized in prior years related to development activities is contingently repayable if the resulting products are commercially successful. Contributions recognized in prior years which may be repayable total $3,749, of which $1,877 may be repayable based on a percentage of sales over an unlimited period and $1,872 may be repayable based on a percentage of sales over a limited period. During 2006 and 2005, no amount was due or repaid. Any subsequent repayments will be recorded as an expense in the period the Company becomes liable to make the payments.

c. In prior years, the Company had received $355 in funding under an agreement with Technology Partnerships Canada to design, develop and commercialize a Simulation Based Interactive Training System ("SBITS"). Under the terms of the agreement, the Company may receive up to $1,236 as a contribution to certain costs incurred up to May 2001 and is required to pay a royalty based on gross revenues from SBITS to a maximum of $1,858. The Company is not currently working on the project and does not expect to in the future. Should the project continue, the contributions and the royalties will be recorded in the period the Company becomes entitled to the contributions and liable for the royalty payments.

d. Under the terms of a military contract with a foreign government, the Company is required to make an investment of $121 into a development fund.

e. In the normal course of business, the Company enters into numerous agreements that may contain features that meet the definition of an indemnification and guarantees to counterparties in transactions such as; the sale of services or products; the purchase of products; and the acquisition of assets or businesses.

f. In the context of business acquisitions or the purchase of assets, the Company may from time to time agree to compensate the seller for breaches of representations and warranties made about the Company pursuant to an acquisition agreement. These representations and warranties typically relate to the corporate existence, authorization and liquidation as it relates to the purchase, and expire on the completion or closing of the transaction. Historically, there have been no claims under such indemnification agreements.

g. In the ordinary course of business, the Company provides indemnification agreements to clients during the sale of services and products. These indemnification agreements require the Company to compensate the client for costs incurred as a result of litigation claims or damages for intellectual property right infringement and other similar items that may be suffered by the client as a consequence of the agreement. Historically, there have been no claims under such indemnification agreements.

h. The nature of the above mentioned agreements prevents the Company from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the liability which stems from the unpredictability of future events and the unlimited coverage offered to counterparties. No amount has been accrued on the balance sheet with respect to these agreements.

i. The Company has entered into the following lease commitments for its office space and other operating leases:

Year	Amount
2007	$ 1,388
2008	1,044
2009	843
2010	838
2011	829
	4,942
Thereafter	1,588
	$ 6,530

19. FINANCIAL INSTRUMENTS

The reported values of financial instruments which consist of cash and cash equivalents, restricted cash, trade and other receivables, unbilled revenue, accounts payable and accrued liabilities, accrued costs on percentage completion, convertible debenture and deferred revenue approximate their fair values due to their current nature.

Carrying value of the mortgage receivable approximates its fair value.

The Company performs periodic credit evaluations of the financial condition of its customers. Allowances are maintained for potential credit losses consistent with the credit risk of specific customers.

Interest rate risk to the Company's operations arises from fluctuations in interest rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

20. NET CHANGE IN NON-CASH WORKING CAPITAL

Net change in non-cash working capital of continuing operations:

	2006	2005
		(Restated - Note 2)
Trade and other receivable	**$ 1,915**	$ (3,442)
Unbilled revenue	**2,977**	(2,924)
Inventory	**(75)**	1,431
Accounts payable and accrued liabilities	**1,880**	2,578
Accrued costs on percentage completion	**337**	(77)
Deferred revenue	**3,766**	4,627
	$ 10,800	$ 2,193

21. RELATED PARTY TRANSACTIONS

All related party transactions are in the normal course of operations, measured at their exchange amounts established and agreed to by the related parties. Amounts due to related parties are subject to normal trade terms. In 2006, the Company paid the following amounts to firms in which a director of the Company is an owner, partner or principal: $297 (2005 - $372) for legal services, $Nil (2005 - $105) for human resource services. The cost of these services was charged to general and administrative expenses. The amount due to related parties included in accounts payable and accrued liabilities as at December 31, 2006 was $54 (2005 - $61).

22. OPTION TO PURCHASE AN ENTITY

In 2005, the Company signed an agreement whereby the Company would have the option to purchase an entity ("acquiree") at a price which includes an amount for the intellectual property and an additional amount based upon the acquiree achieving pre-established sales and income targets. In addition, the Company secured a license to sell certain of the acquiree's products. The option to purchase expires in April, 2008. In return for this option and the acquired license, the Company paid $50 in cash and also provided $447 of support development efforts to the acquiree without charge.

23. SUBSEQUENT EVENTS

On February 27, 2007, 1,225,000 common share purchase warrants were exercised for proceeds of $735.

On March 5, 2007, 231,121 common share purchase warrants were exercised for proceeds of $139.

24. PRIOR YEAR FINANCIAL STATEMENTS

Certain prior year comparatives have been reclassified in order to conform to the current basis of presentation.

CORPORATE INFORMATION

Andrew Day
President and Chief Executive Officer

Terence Donnelly [2]
Executive Vice President
Mandrake Management Consultants Inc.

Robert A. Ferchat, CA, CPA [1,3]
Corporate Director

Donald B. Hathaway, FCMC, ICD.D [2]
Chairman of the Board

David J. McFadden, Q.C. [2,3]
Chair, National Energy and Infrastructure Group
Gowling Lafleur Henderson LLP

Henry Pankratz, FCA [1,3]
President
CavanCore Capital

David Williams [1]
President
Roxborough Holdings Limited

OFFICERS OF ATLANTIS SYSTEMS CORP.:

Andrew Day
President and Chief Executive Officer

John F. Kalas
Senior Vice President and Chief Financial Officer

Douglas Donderi
Corporate Secretary and Vice President, Corporate Development

1. Audit Committee
2. Management Resources Committee
3. Corporate Governance & Nominating Committee

ATLANTIS SYSTEMS INTERNATIONAL, INC.:

Andrew Day
President and Chief Executive Officer

John F. Kalas
Senior Vice President and Chief Financial Officer

Blake Melnick
Chief Operating Officer

Douglas Donderi
Corporate Secretary and Vice President, Corporate Development

Craig Baba
Vice President, Finance

Laurence Esterhuizen
Vice President, Strategic Business Development

Carolyn Godbout
Vice President, Information Technology and Knowledge Systems

Terry Killow
Vice President, Program Management/Systems Engineering

Jay Konduros
Vice President, Operations

Chris Lewis
Vice President, Advanced Programs

Ian McIntyre
Vice President, Marketing and Sales

OFFICERS OF ATLANTIS SYSTEMS AMERICA, INC.:

Arthur A. Marubbio
President

Michael Cook
Secretary

TRANSFER AGENT:

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING:

Toronto Stock Exchange – AIQ

CORPORATE HEAD OFFICE:

1 Kenview Blvd.
Brampton, Ontario
Canada L6T 5E6
Tel: 1 905-792-1981
Fax: 1 905-792-7251
Email: info@AtlantisSI.com

WEBSITE:

www.AtlantisSI.com

Designed and produced by Caithness Marketing Inc.
Printed in Canada on Recycled Paper.

ATLANTIS SYSTEMS CORP.
1 Kenview Blvd.
Brampton, Ontario
Canada, L6T 5E6
www.AtlantisSC.com