

## 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. ("Company" or "we" or "our" or "us" or "ASC") as at and for the three months and six months ended June 30, 2009 with comparisons to the three months and six months ended June 30, 2008 and the year ended December 31, 2008, 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 unaudited consolidated financial statements and the accompanying notes as at and for the three months and six months ended June 30, 2009 and 2008 and the audited annual consolidated financial statements, including the notes, for the year ended December 31, 2008. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP").*

*All amounts, with the exception of the "Highlights and Summary" section of this MD&A, are stated in thousands of Canadian dollars, except per share amounts, unless otherwise noted. All tabular amounts are expressed in thousands of Canadian dollars, except per share amounts. All non-dollar values are as stated. The definitions found in the "Glossary of Technical Terms" section of this MD&A are incorporated into this document.*

*This MD&A is based on information available as at August 14, 2009 except where otherwise noted.*

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## GLOSSARY OF TECHNICAL TERMS <sup>(1)</sup>

Certain technical terms used in this Management Discussion and Analysis are defined as follows:

“ASA” means Atlantis Systems America, Inc.

“ASC” means Atlantis Systems Corp.

“ASE” means Atlantis Systems Eduplus, a separate division of ASC.

“ASI” means Atlantis Systems International Inc.

“CAE-OTSP” means the master OTSP contract, contracted between CAE and the Government of Canada

“CJ-130 FTD Program” means the flight training device program, contracted between the Company and CAE under the CAE-OTSP contract.

“CF” means Canadian Forces.

“CFTS” means contracted flying training and support.

“CPT” means cockpit procedures trainer.

“DND” means Canadian Department of National Defence.

“EBITDA” is means consolidated net income before interest, taxes, depreciation, amortization and non-cash charges and expenses other than accruals made in the normal course of business less any dividends on capital distribution.

“Eduplus” means the Eduplus division of Tecslut Inc., acquired by ASC in the third quarter of 2007.

“GAAP” means Canadian generally accepted accounting principles.

“HVTT” means helicopter virtual task trainer.

“IMTS” means integrated maintenance training system.

“OTSP” means Operational Training Systems Provider

“MD&A” means management’s discussion & analysis

Powertrain is defined as Powertrain Inc.

“PWU” means Power Workers’ Union.

“PWUTI” means Power Workers’ Union Training Inc.

“RDAF” means Royal Danish Air Force.

“SMHP” means Sikorsky Maritime Helicopter Program.

“TSX” means Toronto Stock Exchange

**(1) The definition of the technical terms in this glossary are incorporated into the remainder of this document.**

## 1. HIGHLIGHTS AND SUMMARY

### **Highlights for the Second Quarter of 2009**

- In May 2009, we announced that our wholly owned subsidiary, ASI, had signed a contract with CAE to design and manufacture a C-130J flight training device as part of the Government of Canada C-130J aircrew training program. ASI is part of the pan-Canadian team led by CAE which won a contract to provide systems and services for Canada's tactical airlift, medium-to-heavy helicopter, and potentially other aircraft fleets.
- In April 2009, ASE was awarded a contract for approximately \$2.0 million by L-3 Communications MAPPS Inc. ("L-3 MAPPS") of Montreal for the supply of courseware development and training for the Halifax Class Integrated Platform Management System ("IPMS") Project. The IPMS Project is an upgrade program that will modernize the Canadian Navy's twelve Halifax Class frigates.
- We have secured in total approximately \$8.8 million in new contracts in the first six months of 2009, and in addition have been awarded renewals and increases on existing contracts for approximately \$1.2 million.
- Order backlog at June 30, 2009, for continuing operations was \$32.6 million, an increase of \$4.3 million from the same order backlog at December 31, 2008. The June 30, 2009 backlog includes \$19.1 million for CFTS program, including \$17.7 million for support services to be recognized over the next 18 years, and \$5.7 million for the SMHP.
- During the second quarter of 2009, the Company's board of directors (the "Board") concluded that the future sales prospects for ASA were not sufficient to allow the U.S. subsidiary to become self-sustaining. On this basis the board set an effective date of June 30, 2009, to discontinue U.S. operations. We had previously disclosed that the future of our U.S. operations was under review with respect to our cost reduction initiatives and new strategic direction.
- Throughout the second quarter of 2009 we also continued to successfully implement cost reduction initiatives for Canadian operations without impacting our ability to execute current contracts or pursue identified new opportunities.
- In January 2009, the Company announced it was notified by the Ontario Media Development Corporation ("OMDC") that it was eligible to receive OMDC refundable tax credits of approximately \$1.475 million, net of applicable fees. On April 15, 2009, the Company received a partial payment of approximately \$1.3 million, net of applicable fees, and on May 17, 2009, the balance was received.

## **Recent Developments**

- On December 15, 2008, the Company announced that the TSX had placed the Company under a delisting review as a result of a decline in the market value of the Company's common shares and concerns regarding the Company's financial condition. The Company was reviewed under the TSX's remedial review process and was originally granted 120 days to comply with all requirements for continued listing. After reviewing the Company's submission dated April 5, 2009, the Listing Committee of the TSX deferred its delisting decision until July 3, 2009. After considering the Company's further submission, dated June 29, 2009, the TSX notified the Company on July 12, 2009, that its continuing listing deficiencies had not been rectified. The Company's common shares were to be delisted on the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review.
- On July 14, 2009, CEO Capital provided a \$250 bridge loan to the Company, secured by a promissory note. The promissory note is due on November 11, 2009, plus accrued interest at 2% per month, unless the due date is extended at CEO Capital's sole option.
- In July 2009, the Company reached an agreement with a U.S. based company to transfer our qualification rights to bid as a contractor with the U.S. Army under STOC II. We have received an irrevocable payment of \$130 for completing a written submission to the U.S. Government to transfer these rights ("Novation Request"). An additional \$130 would be due providing that the Novation Request is approved by the U.S. Government (see "Discontinued Operations").

## **Summary of the Second Quarter 2009 Results and Other Information**

- Revenue from continuing operations for the three months ended June 30, 2009 was \$2.0 million, a 48% decrease from revenue from continuing operations of \$3.8 million in the second quarter of the prior year. Revenues in the second quarter of 2009 and 2008 include a decrease in revenues related to prior periods due to reconfigured cost estimates to complete major programs of \$0.5 million and \$1.3 million, respectively. The second quarter of 2009 also includes a decrease a \$0.5 million in revenue from the SMHP due to a decrease during the quarter in the value of the U.S. dollar as compared to the Canadian dollar. Excluding the effect of these adjustments to revenue for both quarters, revenue for continuing operations in the second quarter of 2009 would have decreased by 42% to \$3.0 million.
- Revenue from continuing operations for the six months ended June 30, 2009 was \$5.4 million, a 30% decrease from revenue from continuing operations of \$7.8 million in the same period of the prior year. Revenue in the first six months of 2009 includes an increase in revenue related to prior periods of \$0.4 million due to reconfigured cost estimates to complete major program, as well as increases in forecasted support billings from the application of escalation clauses in the CFTS contract, and other onetime reconfigured project cost estimates. Revenue in the same period in 2008 includes a decrease in revenue of

\$1.7 million due to reconfigured cost estimates to complete major programs. In addition, revenue in 2009 includes a decrease in revenue of \$0.4 million from the SMHP due to changes in foreign exchange rates. Excluding the effect of these adjustments to revenue for both periods, revenue for continuing operations in the six-month period of 2009 would have decreased by 42% to \$5.4 million.

- Net loss from continuing operations for the three months ended June 30, 2009 was \$2.6 million, as compared to a net loss of \$2.0 million for the same period of 2008. The second quarter of 2009 includes a write-off of \$0.6 million for certain financing costs associated with the Company's term debt (see below).
- Net loss from continuing operations for the six months ended June 30, 2009 was \$2.6 million as compared to a net loss of \$3.6 million in the same period in 2008. In addition to the items affecting revenue and net income as discussed above, the net loss from continuing operations in the first six months of 2009 was reduced by approximately \$1.475 million from OMDC refundable tax credits, net of applicable fees.
- As at June 30, 2009, the Company was not in compliance with a covenant in its financing arrangement with ComVest Capital, LLC ("ComVest") relating to a requirement for a minimum EBITDA to Fixed Charges ratio. In addition, as at June 30, 2009, the Company had exceeded the maximum borrowing limit per the terms of its agreement with ComVest. The Company chose not to request a waiver from ComVest for the reporting period ended June 30, 2009 for both the breach of covenant and exceeding the maximum borrowing limit to avoid incurring a waiver fee. As a result of our "in default" condition, we have written-off approximately \$0.6 million of financing costs associated with securing the term loan from ComVest. In addition, effective April 1, 2009, ComVest began charging an additional default interest of 5% per annum.

## 2. 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 MD&A, and in particular the Business Outlook for the remainder of 2009 on page 30, contains 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. For information regarding risks and uncertainties that could affect our business, please see the Description of the Business – Risk Factors section in our Annual Information Form, and the section filed in our MD&A for the year ended December 31, 2008 contained in our 2008 Audited Financial Statements, both of which are available on the System for Electronic Data and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com)

It is important to note that:

- Unless otherwise indicated, forward-looking statements in this MD&A describe our expectations as of August 14, 2009.
- 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.

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 and on our website at [www.atlantissi.com](http://www.atlantissi.com).

### 3. WHO WE ARE

Since our Company was founded 30 years ago, we have developed into a well recognized provider of simulation-based training technology, primarily targeted to the military and commercial aviation industries, where we have gained a solid reputation for our technological capabilities and innovative solutions. In recent years, we have expanded our services into the energy sector.

In the past several years, we have also broadened our capabilities and core competencies which now include simulation, e-learning and knowledge management systems and expertise, hardware and software integration and virtual reality.

We are headquartered in Brampton, Ontario and have an office in Halifax, Nova Scotia.

#### *Our Core Values*

- Quality – we focus on our customers, their requirements and expectations.
- Innovation – we use responsible creativity to craft the best solutions.
- Integrity – we act ethically in our professional endeavours.
- Accountability – we are responsible and meet our commitments.
- Teamwork – we believe in spirited collaboration.

### 4. OUR TRADITIONAL MARKETS

### *Military*

Our roots are in the military and we will continue to strengthen our position in this market.

There are a number of important trends in the military that favour the services we provide:

- there is a trend towards outsourcing to better manage military budgets and to encourage more innovative training solutions;
- expected high levels of attrition across armed forces creates a requirement to train more qualified technicians and trainers in less time;
- the nature of warfare is changing and the use of sophisticated computer systems in communications, weapons delivery and networking lends itself perfectly to the use of synthetic training and performance-based learning systems;
- with the advent of more powerful computers, more sophisticated peripheral technology and enhanced graphics, the realism in simulation has resulted in an ever-increasing acceptance of this learning approach by the military; and
- the cost of simulation technology has been drastically reduced making it much more affordable to a wider base of applications and users.

The CF have an unprecedented number of major acquisition programs either underway or planned, including new airlift airframes, modernization of its frigates, new multi-purpose ships, new trucks and tanks, a replacement fixed-wing search and rescue platform and arctic patrol boats, as well as other recently announced programs. All of these programs will require performance critical learning systems. Our capabilities position us well to capture a significant share of the training dollars for these programs.

### *Civil Aviation*

We have been involved with the civil aviation industry since our inception and continue to view this market with interest. We expect the coming years will bring an unprecedented worldwide shortage of qualified commercial pilots due to the following trends:

- a significant global growth in civil aviation that is expected to continue;
- a significant proportion of the pilot population is approaching retirement age; and
- fewer military pilots are transferring to civil aviation.

Our flight training devices, cockpit procedures trainers and flight simulators are installed and operating around the world and we will continue to take a keen interest in the civil aviation industry worldwide.

### *Other Potential Markets*

We believe that there are numerous other markets that would benefit from our synthetic learning

systems. These include the energy, medical industry, complex industrial facilities and the transportation industry. However, we do not intend to actively pursue these industries at this time unless an unexpected opportunity arises.

## 5. OUR TRADITIONAL TRAINING ORIENTED VALUE EQUATION

We believe that our integrated training systems and learning solutions allow our customers:

- to train students economically;
- to significantly reduce instructor-to-student ratio;
- to significantly reduce the cost of training by freeing up expensive assets such as fighter planes and full flight simulators through the use of simulation and virtual reality;
- to speed up the learning process and enhance the quality of learning through continuous performance assessment, feedback mechanisms and the realism of the training simulation;
- to maintain training consistency and discipline between groups that trained at different times and by different instructors;
- to pre-screen students for their suitability in operational roles; and
- to cost effectively update their training programs.

## 6. OUR NEW STRATEGIC DIRECTION

In the second half of 2008, we changed our strategic focus and positioning to leverage our core competencies and existing technologies in order to broaden the value we provide to our existing customer base. We implemented strategic account management practices in order to better focus our business development and research and development activities with a view to capitalizing on additional opportunities to use simulation methods to service the full life cycle of our customers' products.

The Company is aggressively pursuing new business opportunities that align with its new strategic direction.

In the third quarter of 2008, we identified the near-term priorities for the Company as follows:

- structural alignment to support the new business model;
- fill the missing elements of our resource requirements;
- restructure our sales organization to develop strategic account management;
- secure key strategic partnerships;

- increase our emphasis and investment in nuclear;
- secure targeted organic business.

Since then, we have developed a new strategic plan, restructured our management team, hired a new Chief Executive Officer, discontinued our unprofitable U.S. operation, established separate business units under the leadership of a single individual with full profit and loss responsibility, implemented additional cost reductions of approximately \$1.5 million per year and have, under difficult circumstances, maintained a good banking relationship with ComVest.

We have implemented strategic account management, focusing our initial efforts on four strategic accounts. This narrow, but deep, approach to account management has already begun to show results. Since the beginning of 2009, we have secured approximately \$10.0 million in new or amended contracts, including a contract with CAE to design and manufacture a C-130J FTD as part of the Government of Canada C-130J aircrew training program, a \$2.0 million e-learning contract with L-3 MAPPS to be a subcontractor for a project with the Canadian Navy, and a \$1.3 million e-learning contract with the DND.

Our continuing priorities are as follows:

- recapitalize the Company;
- further reduce our cost structure;
- aggressively seek out new business;
- List our shares on alternative registered market;

## 7. OTHER COMPANY INFORMATION

We are registered under a number of quality management programs including ISO 9001:2008, AS9100:2004, CSA-Z299.1-1985, Boeing BQMS D6-82479 and Rockwell Collins RC-9000, among others.

We operate through our wholly-owned subsidiary ASI, and through ASE, a division of ASC.

At June 30, 2009, we had a total head count of 111, of which 31 were with the ASE division in Halifax, Nova Scotia.

## 8. COMVEST AGREEMENT

Effective April 30, 2008, the Company entered into financing arrangements by way of a revolving credit and term loan agreement (the “ComVest Agreement”) with ComVest that provided up to U.S.\$6.6 million of financing in the form of a secured term loan (the “ComVest Term Loan”) in the amount of U.S.\$2.6 million at a rate of interest of 12.5% per annum payable

monthly and a deferred interest fee of 5% per annum payable at maturity, as well as a secured revolving line of credit (the “ComVest Operating Line”) of up to U.S.\$4.0 million based on a borrowing base at a rate of interest of U.S. prime plus 2% per annum with a floor of 8%. The ComVest Term Loan matures on April 30, 2011 and the ComVest Operating Line will be available until April 30, 2010, subject to a one-year extension at the option of the Company. The arrangement also involved the Company issuing the ComVest Warrants, with an expiry date of April 30, 2013, to acquire an aggregate of 9,300,000 common shares at an exercise price of \$0.09 per share.

As discussed further in the “Liquidity” section of this document, the Company has been for all reporting periods commencing with June 30, 2008, in breach of a certain covenant under the ComVest Agreement and for all reporting periods commencing September 30, 2008, has exceeded its maximum borrowing capacity under the ComVest Operating Line.

The Company chose not to request waiver for the breach of this covenant at June 30, 2009, or for the Company exceeding its maximum borrowing limit for the revolving Line of Credit on June 30, 2009 to avoid paying a waiver fee. As a result of these “in default” conditions, the un-accreted balance of \$594 for the finance costs associated with obtaining the ComVest Term Loan were written-off in the second quarter of 2009, and the entire balance of the Term Loan has been classified as a current liability. The Company had previously anticipated that it would violate covenant requirements at future compliance dates and had therefore previously presented the entire balance of the Term Loan as a current liability.

The Company had secured waivers without a fee for the applicable reporting periods prior to December 31, 2008. On March 25, 2009, the Board agreed to re-price the ComVest Warrants from \$0.09 to \$0.03 per share. The warrant re-pricing is in lieu of covenant waiver fees that would have been otherwise charged by ComVest for waivers for the March 31, 2009 and December 31, 2008 reporting periods.

Effective April 1, 2009, ComVest began charging additional default interest of 5% per annum on both the Line of Credit and the Term Loan. The floor interest rate for the Line of Credit and the monthly interest rate for the Term Debt increased to 13% per annum and 17.5% per annum, respectively, for periods that the Company is in default. The deferred interest rate of 5% per annum for the Term Debt has not changed.

## 9. TSX DELISTING REVIEW

On December 12, 2008, the TSX placed the Company under a delisting review, pursuant to Part VII of the TSX Company Manual, as a result of a decline in the market value of the Company’s shares and concerns with the Company’s financial condition.

The Company was reviewed under the TSX’s remedial review process and was initially granted 120 days to comply with all requirements for continued listing. After reviewing the Company’s submission dated April 5, 2009, the Listing Committee of the TSX informed the Company on April 9, 2009 that the TSX had determined to defer its delisting decision until July 3, 2009. After considering the Company’s further submission, dated June 29, 2009, the TSX notified the

Company on July 12, 2009 that the Company has not met the requirements for continued listing. The Company's common shares were to be delisted on the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review.

## 10. DISCONTINUED U.S. OPERATIONS

ASA, the Company's wholly owned U.S. subsidiary, was established in 2006 to provide a direct U.S. presence in order to better facilitate winning contracts with U.S. defense contractors and the U.S. military. However, the U.S. military market, while very large, has continued to prove difficult for ASA to penetrate. We had previously disclosed, consistent with our cost reduction program and our implementation of strategic account management, that unless a sizeable U.S.-based contract was obtained that was sufficient to sustain our U.S. operations, we expected to exit this market during 2009.

During the second quarter of 2009, the Board concluded that the future sales prospects for ASA were not sufficient to allow the U.S. subsidiary to become self-sustaining. On this basis the Board set an effective date of June 30, 2009, to discontinue U.S. operations. As a result, under Canadian GAAP, the remaining (see below) current assets and liabilities of ASA have been segregated and presented separately as discontinued on the consolidated balance sheet as at June 30, 2009, and all assets and liabilities of ASA have been segregated and presented separately as discontinued on the consolidated balance sheet as at December 31, 2008. The results of operations and cash flows of ASA have been segregated and presented separately as discontinued in the consolidated statements of operations, comprehensive loss and deficit and the consolidated statements of cash flows for the three months and six months ended June 30, 2009 and 2008.

Subsequently, and independent of the decision to discontinue U.S. operations, the Company sold the capital assets of ASA for \$21 to U.S. based third parties. The carrying values of these assets were previously written down to fair values, less costs to sell.

At the time of the Board's decision, ASA had completed all external revenue generating contracts and its only current remaining revenue generating activities were on behalf of ASI. ASA had provided notice of its intention to not renew the lease on its rental premises, which expired on June 30, 2009.

ASA had previously been qualified by the U.S. Army Program Executive Office for Simulation, Training and Instrumentation as a contractor under STOC II. STOC II is an indefinite delivery/indefinite quantity contracting vehicle that was created to quickly procure the next generation of simulation and training products for use by the U.S. and coalition service members. ASA's qualification provided it with the opportunity to bid on future contracts with the U.S. Army. In July, 2009 we agreed to transfer this right to a U.S. based third party in accordance with U.S. Government procedures for addressing such transfers (see – "Subsequent Events").

Summarized balance sheet information for discontinued operations is as follows:

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b>Current assets</b>		
Cash	\$ 3	\$ 59
Trade receivables	247	72
Unbilled revenue	-	-
Prepaid expenses	21	60
<b>Current assets of discontinued operations</b>	<b>\$ 271</b>	<b>\$ 191</b>
<b>Capital assets, net, of discontinued operations</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 39	\$ 133
Deferred Revenue	-	214
<b>Current liabilities of discontinued operations</b>	<b>\$ 39</b>	<b>\$ 347</b>

Excluded in accounts payable for discontinued operations is \$8,230 (December 31, 2008 – \$7,565) payable to the Company.

For a further discussion on the results of discontinued operations, see “Results of Operations – Discontinued Operations”.

## 11. COST REDUCTION INITIATIVES

The Company initiated a cost reduction plan in the fourth quarter of 2007 in order to reduce costs and overall operating expenses by approximately 15% per year. Workforce reductions and other cost cutting measures were expected to result in annualized savings of approximately \$6.4 million. Through March 31, 2009, the cost reductions we have achieved as a result of the initial plan are consistent with the original estimates.

In the fourth quarter of 2008, we incurred additional restructuring costs of approximately \$846, net of prior year accrual reversals, which included future estimated payments of \$863 under settlement agreements with three former Canadian based executive officers of the Company. This further restructuring is expected to result in annualized cost savings of approximately \$1.5 million in 2009.

During the first quarter of 2009, the Company initiated discussions with its landlord to negotiate rent relief at the Company’s Brampton, Ontario location. To-date the discussions have not resulted in an agreement for lower monthly payments. However, on July 7, 2009, the Company reached an agreement (the “Stand Still Agreement”) with its landlord whereby the Company can continue to defer certain past due rental payments until December 31, 2009, provided that

monthly payments are current for July, 2009 (10<sup>th</sup> of the month for July) and through to the end of December 31, 2009 (the “Stand Still Period”).

The Company entered into a sale-leaseback arrangement with its landlord in 1998 with the lease expiring on November 30, 2013. Under the Stand Still Agreement, the Company has forfeited its right to the final mortgage payment, which was due December 1, 2013. The mortgage receivable of \$167 (discounted at 9%) was written off in the second quarter of 2009. However, provided the Company continues to comply with the terms of the Stand Still Agreement and original lease agreement, the landlord will credit the final mortgage payment of \$200 towards the rent payable for October 2013 and November 2013.

Management believes that the current premises are too large for the Company’s current and anticipated levels of operation. Management is continuing with its efforts to secure rent relief and is considering other options.

During 2009, the Company has also implemented additional layoffs, eliminated quarterly audit reviews and reduced the cash outflow on severance payments by unilaterally reducing the payout by 50%, thereby extending the payout period to offset the reduced payout amount. Through June 30, 2009, the cost reductions we have achieved as a result of these further cost reduction initiatives are consistent with our original estimate.

To date, cost reductions at the Canadian operations have not impacted the Company’s ability to execute current contracts, or pursue identified new opportunities, as our workforce reductions have been primarily focused on non-revenue generating positions.

During the second quarter of 2009, the Company’s board of directors concluded that the future sales prospects for ASA were not sufficient to allow the U.S. subsidiary to become self-sustaining. On this basis the board set an effective date of June 30, 2009 to discontinue operations. We had previously disclosed that the future of our U.S. operations was under review with respect to our cost reduction initiatives and new strategic direction.

## 12. THE CFTS PROGRAM

Early in the second quarter of 2005, the Allied Wings consortium was awarded a \$1.77 billion contract for the CFTS program by the DND and the CF to provide the design, development, installation, operation and support for the CFTS ground-based training system in Southport, Manitoba over approximately a twenty-three year period. Atlantis is one of the five members of the Allied Wings consortium with Kelowna Flightcraft Ltd. (“Kelowna”) as the prime contractor.

Our portion of the contract, which started in 2005, is currently expected to generate approximately \$72.1 million in revenues for the production phase and a further approximately \$18.8 million (including amounts recognized to date) for the twenty-year support services phase. The expected costs to complete both the production phase and the support program are reviewed regularly by project management and finance, and as a result, the respective final contract values are subject to fluctuation. During 2008, the value of the CFTS contract increased by

approximately \$1.1 million due to additional work covered by contract amendments and the inflation escalation clause for the support phase of the contract. This contract value further increased during the first quarter of 2009 by approximately \$0.7 million due to the inflation escalation clause for the support phase of the contract.

The initial phase of our contribution to the CFTS program involves the provision of an integrated training solution to the consortium. We, including ASA through June 30, 2009, develop and manufacture some components of this solution “in-house”, while a significant portion were provided by subcontractors.

Throughout the second quarter of 2009, we have continued to deliver on our commitments under the CFTS program. To date we have recognized revenues of \$71.8 million,, including support revenues to date, and as of June 30, 2009 we had completed approximately 98% of the initial production phase, while the full contract, including the support phase, was approximately 79% complete. The Company’s percentage-of-completion revenue-recognition policy is based on the full contract value. The unrecognized remainder on the contract of \$19.1 million includes \$17.7 million for the 20-year support phase that commenced in the fourth quarter of 2007. The remaining deliverables on the initial production phase are scheduled for completion during 2009. The support revenues have been combined with the initial production phase revenues for the above and for all subsequent disclosure in this document.

In the fourth quarter of 2008, our senior management team visited the Southport facilities and met with the Allied Wings management team as part of our ongoing effort to deepen relationships with our strategic accounts. During this visit it became apparent that there is a potential for a significant recurring revenue stream from the CFTS program available to Atlantis, including courseware refresh and upgrades and new flight training devices. Since then we have identified specific areas of improvement, and we have also taken steps to establish a team to provide us with a permanent presence at the Southport facility.

### 13. POWERTRAIN

In June 2008, we entered into a shareholders’ agreement with PWUTI, a wholly-owned subsidiary of PWU to create a company called Powertrain, intended to be the primary vehicle to penetrate the energy sector in Ontario and beyond. As part of the arrangement, Atlantis was to contribute certain technology to Powertrain and PWUTI was to contribute approximately \$1.6 million in cash in three tranches. Pursuant to the agreement, Atlantis has placed certain technology into escrow and has developed an IMTS-based nuclear simulation demonstration. The Company’s new leadership is of the view that the respective interests of the parties and the vision for Powertrain are not properly defined. To this end, a considerable amount of effort has been spent by both parties to address issues, define respective interests and move towards a common vision. Until a well defined vision can be articulated, and interests are aligned, the parties have agreed to suspend the funding of Powertrain. We expect that the current agreement will be revised in the near future for the benefit of both parties.

## 14. RESULTS OF OPERATIONS

The following discussion is for the continuing operations of the Company, apart from the paragraphs that pertain explicitly to discontinued operations, thereby providing a separate discussion of the material factors influencing the continuing and discontinued operating results and financial condition of our Company, as at, and for the three months and six months ended June 30, 2009, with comparisons to the three months and nine months ended June 30, 2008, where applicable.

Continuing operations of the Company include the operating entities ASI and ASE (a division of ASC), and corporate overheads. Discontinued operations of the Company are those of ASA.

### Summary Financial Information for Continuing Operations

	For the three months ended		For the six months ended	
	June 30		June 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
Revenue from continuing operations	1,992	3,835	5,454	7,815
Gross margin from continuing operations	325	438	2,621	955
Gross margin percentage	16%	11%	48%	12%
Operating expenses from continuing operations <sup>(1)</sup>	1,423	1,647	2,933	3,249
Depreciation and amortization from continuing operations	359	480	715	961
Interest expense and financing costs from continuing operations	1,018	309	1,372	387
Net loss from continuing operations	(2,642)	(1,998)	(2,566)	(3,642)
Net loss per share (basic) from continuing operations	(0.05)	(0.04)	(0.05)	(0.07)
Net loss	(2,935)	(2,337)	(3,046)	(4,639)
Net loss per share (basic)	(0.05)	(0.04)	(0.05)	(0.08)
Total assets at end of period for continuing operations	7,029	23,207	7,029	23,207

<sup>(1)</sup> Includes selling and marketing ("S&M"), general and administrative ("G&A") and stock option expense.

### Going Concern Assumption

These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to meet its commitments, realize its assets and discharge its liabilities in the normal course of business.

For the six months ended June 30, 2009 the Company incurred a net loss of \$3,046, and has a working capital deficiency of \$8,520, a deficit of \$105,426 and a shareholders' deficiency of \$6,223 as at June 30, 2009. This casts substantial doubt on the Company's ability to continue as a going concern. Continuation of the Company as a going concern is dependent upon achieving profitable operations, and/or the ability of the Company to obtain additional financing when necessary.

In addition, On December 12, 2008, the TSX placed the Company under a delisting review, pursuant to Part VII of the TSX Company Manual, as a result of a decline in the market value of the Company's shares and concerns with the Company's financial condition. The Company was

reviewed under the TSX's remedial review process and was initially granted 120 days to comply with all requirements for continued listing. After reviewing the Company's submission dated April 5, 2009, the Listing Committee of the TSX informed the Company on April 9, 2009 that the TSX had determined to defer its delisting decision until July 3, 2009. After considering the Company's further submission, dated June 29, 2009, the TSX notified the Company on July 12, 2009, that the Company has not met the requirements for continued listing. The Company's common shares were to be delisted on the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review.

If the going concern assumption were not appropriate for these financial statements, adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications used.

In the opinion of management, all adjustments considered necessary for fair presentation of the Company's financial position, results of operations and cash flows have been included. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for any future periods.

### **Continuing Operations**

The components of revenue for continuing operations for the three months and six months ended June 30, 2009 and 2008 are as follows:

	Three Months Ended June 30,					
	2009		2008		Change	
	\$	%	\$	%	\$	%
<b>CFTS</b>	340	17%	1,888	49%	(1,548)	-82%
<b>SMHP</b>	138	7%	638	17%	(500)	-78%
<b>Other military</b>	960	48%	381	10%	579	152%
<b>Other</b>	554	9%	928	-12%	(374)	-40%
<b>Total</b>	1,992	100%	3,835	100%	(1,843)	-48%

	Six Months Ended June 30,					
	2009		2008		Change	
	\$	%	\$	%	\$	%
<b>CFTS</b>	1,395	26%	3,677	47%	(2,282)	-62%
<b>SMHP</b>	1,186	22%	1,187	15%	(1)	0%
<b>Other military</b>	1,592	29%	1,357	17%	235	17%
<b>Other</b>	1,281	16%	1,594	3%	(313)	-20%
<b>Total</b>	5,454	100%	7,815	100%	(2,361)	-30%

Revenue from continuing operations for the three months ended June 30, 2009, as compared to the prior year, decreased by \$1,843, or 48%. Revenue from continuing operations decreased in the first quarter of 2009 due to the maturing of the CFTS program as well as reductions in revenue generated by the SMHP and the energy sector, offset, in part, by revenue from recently awarded military contracts for e-learning programs and the C-130J FTD program. Revenues in the second quarter of 2009 and 2008 include a decrease in revenues related to prior periods due to reconfigured cost estimates to complete major programs of \$479 and \$1,317 million, respectively. The second quarter of 2009 also includes a decrease of \$532 in revenue from the SMHP due to a decrease during the quarter in the value of the U.S. dollar as compared to the Canadian dollar. Excluding such effects on all revenue, revenue from continuing operations would have decreased in the six months ended June 30, 2009 by 42% to \$3,003.

Revenue from continuing operations for the six months ended June 30, 2009 was \$5,454, a 30% decrease from revenue from continuing operations of \$7,815 in the same period of the prior year. Revenue in the first six months of 2009 includes a net increase in revenue of \$442 (2008: a net decrease of \$1,666) due to reconfigured cost estimates to complete programs as well as an increase in the CFTS contract value from the application of escalation clauses to the support phase of the CFTS contract for 2009. In addition, revenue in 2009 includes a decrease in revenue of \$394 (2008: an increase of \$97) from the SMHP due to a decrease during 2009 in the value of the U.S. dollar as compared to the Canadian dollar. Excluding such effects on all revenue, revenue from continuing operations would have decreased in the six months ended June 30, 2009 by 42% to \$5,406.

In most instances the projects undertaken by the Company require many months to complete. Accordingly the Company recognizes revenue on these projects based on the percentage of costs completed for each project. Adjustments in the period to previously recognized revenues can occur as a result of a change in estimate to the total project cost resulting in a higher or lower percentage completion. When the contract value changes the change in the contract value must be recognized in revenue in the current reporting period for the percentage-of-completion achieved to date.

In the case of the CFTS program both the production phase and the support phase are considered one project for revenue recognition purposes and revenues are recognized over a 20 year time period. A total of \$71.8 million of revenues have been recognized to date on a total contract value of \$90.9 million. This initial production portion entered into its mature phase in the third quarter of 2007 and revenues from this program have correspondingly declined in subsequent quarters. The support services portion of the CFTS contract commenced in the fourth quarter of 2007 and has approximately \$17.7 million remaining that will be recognized over the next 18 years. We believe that our performance on the CFTS contract will lead to additional contracts with both the DND and the CF.

Revenue from the CFTS program for the three months and six months ended June 30, 2009 includes a net decrease in revenue of \$479 (2008: \$461) and \$101 (2008: \$810), respectively, due to reconfigured cost estimates to complete this program and an increase in the CFTS contract value from the application of escalation clauses to the support phase of the CFTS contract. Excluding these effects on revenue, CFTS revenue would have decreased by 65% to \$819 and decreased by 67% to \$1,496, in the three months and six months ended June 30, 2009, respectively, as compared to the corresponding period in the prior year.

We acquired the SMHP contract with the completion of the Eduplus acquisition on September 27, 2007. ASE provides the program with training design, training documentation and courseware production. We expect revenues from this program through 2011. Our SMHP contract calls for the development of e-learning based courseware (courseware developed for use on a computer system). We substantially augmented this core competency with the Eduplus acquisition and we are committed to increasing our share in this important segment of our marketplace.

This contract with Sikorsky Aircraft Corp. ("Sikorsky") is denominated in U.S. dollars and the contractual value has remained unchanged since the Eduplus acquisition. The decrease in the value of U.S. dollar to the Canadian dollar at June 30, 2009, from March 31, 2009, resulted in a decrease of \$532 in SMHP revenues for the second quarter of 2009. The affect of exchange rate fluctuations on SMHP revenues in the second quarter of 2008 were minimal. In addition, revenue in the six month period in 2009 includes a decrease in revenue of \$394 (2008: an increase of \$97) from the SMHP due to the decrease during 2009 in the value of the U.S. dollar. In addition, revenue in the first six months of 2009 includes an increase in revenue of \$543 from the reconfiguration of cost estimates to complete this program in the first quarter of 2009. Excluding such effects on revenue, SMHP revenues

would have increased by 5% to \$670 in the second quarter of 2009 and decreased by 5% to \$1,037 in the first six months of 2009, as compared to the corresponding periods in 2008.

Revenue from other military contracts increased by approximately 150% to \$960 and 17% to \$1,592 in the three months and six months ended June 30, 2009, respectively, as compared to the corresponding period in the prior year. Other military revenue in 2009 was primarily derived from contracts awarded in 2009, and in particular, for e-learning programs with ASE and from the C-130J FTD contract with CAE, as well as from an upgrade program for the CPT previously delivered to the RDAF for the EH-101 helicopter. Other military revenue in both the second quarter and the six month period of 2008 was primarily derived from the RDAF program, which was substantially completed in the third quarter of 2008. Revenue in the second quarter of 2008 includes a decrease in revenue of \$856 due to reconfigured cost estimates to complete this program. Excluding this effect on revenue, revenue from other military contracts would have decreased by 22% and 28% during the three months and six months ended June 30, 2009, respectively.

In May 2009, ASI secured a contract with CAE to design and manufacture the C-130J flight training device as part of the Government of Canada C-130J aircrew training program. ASI is part of the pan-Canadian team led by CAE which won a contract to provide systems and services for Canada's tactical airlift, medium-to-heavy helicopter, and potentially other aircraft fleets.

E learning contracts awarded to ASE in 2009 include a \$1.3 million contract with the DND to design, develop and deliver a professional development training package for aircraft maintenance workers who are preparing to assume supervisory positions as well as from the recently awarded contract with L-3 MAPPS for approximately \$2.0 million. The remaining e-learning revenues are from five smaller projects awarded to ASE in the first quarter of 2009.

Other revenues from continuing operations in the three months and six months ended June 30, 2009 and 2008 were derived from multiple, small and short-duration contracts and from energy sector contracts. Revenues from customers in the energy sector decreased by 72% to \$123 and decreased by 42% to \$290 in the three months and six months ended June 30, 2009, respectively, as compared to the corresponding period in the prior year. These decreases were primarily due to revenue recognized of \$362 in the second quarter of 2008 for a short-term \$450 contract to provide an IMTS for use as a prototype for training technicians in power plants.

During the quarter ended June 30, 2009, we had two customers from continuing operations that represented more than 10% of total revenue, the CF with 30% (2008: 45 %) and CAE with 17% (2008: nil%). As at June 30, 2009, three customers from continuing operations represented more than 10% of total combined trade receivables and unbilled revenue as follows: Sikorsky with 53% (2008: 16%); CAE with 14% (2008: nil%); and the RDAF with 12% (2008: 38%).

During the six months ended June 30, 2009, we had two customers from continuing operations that represented more than 10% of total revenue, the CF with 30% (2008: 43%) and Sikorsky with 20% (2008: 14%).

In addition, the revenue from discontinued operations from a large U.S. defense contractor represented 14% (2008: 10%) and 13% (2008: 9%) of the total revenue in the three months and the six months ended June 30, 2009, respectively. A receivable of \$232 was outstanding from this contractor at June 30, 2009.

The order backlog for continuing operations at June 30, 2009 of \$32.6 million includes the following: \$19.1 million from the CFTS program (with approximately \$17.7 million for future support services); \$5.7 million from the SMHP; \$7.4 million in total from three large contracts awarded in 2009; and \$0.4 million from all other contracts.

The order backlog for continuing operations at June 30, 2009, increased by \$4.3 million from the same backlog at December 31, 2008 (which included \$17.4 million in future support services). The increase in backlog was to the result of outpacing the decrease from revenues from continuing operations of \$5.4 million with the following changes in order backlog: new contracts and contract extensions and amendments awarded in the first six months of 2009 of approximately \$10.0 million; the gross decrease (before revenue is recognized on a percentage of completion basis) of approximately \$0.9 million in the SMHP backlog from the conversion of this U.S. dollar denominated contract to Canadian dollars; and test equipment sales as well as revenue from small contracts of approximately \$0.6 million. 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 from continuing operations for the quarter ended June 30, 2009 was \$325, or 16% of revenue for continuing operations, as compared to a gross margin of \$438, or 11% of revenue, for the same period in 2008.

Gross margin from continuing operations for the six months ended June 30, 2009 was \$2,621, or 48% of revenue from continuing operations, as compared to a gross margin of \$955, or 12% of revenue, for the same period in 2008.

With the exception of the RDAF project, the gross margins from continuing operations for the second quarters of 2009 and 2008, and for the six-month periods ended June 30, 2009 and 2008, are affected on an equal basis by the corresponding changes in revenue for each period for cost reconfigurations and exchange rate differences. The gross margin in the second quarter of 2008 includes a net reduction of only \$168 from the RDAF program due to reconfigured cost estimates.

In addition, the gross margin from continuing operations in the three months and the six months ended June 30, 2009 also includes a reduction in the cost of revenue of \$1,306 and \$167, respectively, from the recognition of OMDC refundable tax credits, net of applicable fees. Excluding for both periods the effect of reconfigured cost estimates, exchange rate differences and refundable tax credits, the adjusted gross margin percentages for the three months and the six months ended June 30, 2009, would have been 39% (2008: 21%), and 20% (2008: 20%), respectively.

The adjusted gross margin percentage from continuing operations in the six months ended June 30, 2009 was affected by the impact of absorbing non-variable overhead on a lower adjusted revenue base than for the same period in 2008, offset by the higher gross margin percentages generally available from non-CFTS programs. The higher adjusted gross margin in the second quarter of 2009, as compared to the second quarter of 2008, was attributable to the higher than normal intrinsic-margins available from the contracts awarded in 2009, and to the relatively small contribution of the adjusted revenue from the CFTS program.

We incurred G&A expenses from continuing operations of \$1,120 and \$2,167 for the three months and six months ended June 30, 2009, respectively, a decrease of 7.9% and 11%, respectively, as compared to the corresponding period in 2008.

We incurred S&M expenses from continuing operations of \$260 and \$670 for the three months and six months ended June 30, 2009, respectively, a decrease of 34% and 9%, respectively, as compared to the corresponding period in 2008.

The reduction in both G&A and S&M expenses is a reflection of our ongoing cost reduction efforts, partially offset by an increase in 2009 for professional and consulting fees.

We recorded stock option expenses of \$43 (2008: \$36) and \$96 (2008: 72) for the second quarter and the six months ended June 30, 2009, respectively.

We expect that operating costs for the remainder of 2009 will decrease from the levels experienced in 2008.

We incurred depreciation and amortization expense for continuing operations for the second quarter of 2009 of \$359, a decrease of \$121 over the same period in 2008. We incurred depreciation and amortization expense for continuing operations for the six months ended June 30, 2009 of \$715, a decrease of \$246 over the same period in 2008. These decreases are primarily due to the amortization expense recorded during 2008 of \$108 per quarter for the HVTT deferred development costs. The HVTT deferred development costs were written off in the fourth quarter of 2008.

Interest expense and financing costs, net, for continuing operations, increased by more than 220% to \$1,018 from the second quarter of 2008. The second quarter of 2009 net expense includes the write-off of \$594 for the un-accreted financing costs related to the ComVest Term Loan as a result of not requesting a waiver, interest expense of \$409, and finance and bank charges, support fees and other costs of \$21, offset, in part, by interest income of \$6. The 2008 second quarter interest expense and financing costs, net, includes interest expense of \$263, and finance and bank charges, support fees and other costs of \$58, offset, in part, by \$12 of interest income.

Interest expense and financing costs, net, for continuing operations for the six months ended June 30, 2009, increased by more than 250% to \$1,372 as compared to \$387 in the same period of 2008. The six months ended June 30, 2009, net, expense includes the write-off of the un-accreted

financing costs, interest expense of \$745 and finance and bank charges, support fees and other costs of \$64, offset, in part, by interest income of \$31. For the same period in 2008, interest expense and financing costs, net, includes interest expense of \$311, and finance and bank charges, support fees and other costs of \$109, offset, in part, by \$33 of interest income.

The increase in the interest expense component of \$146 and \$434 for the three months and six months ended June 30, 2009, respectively, over the corresponding prior year period, is primarily the result of the following: higher interest rates on the ComVest Term Loan than the old term loan; the interest not incurred on the ComVest Operating Line prior to May 5, 2008; the greater amounts borrowed in 2009 on the ComVest Operating Line; and the default interest rate increase of 5%, effective April 1, 2009, on both the ComVest Term Loan and the ComVest Operating Line.

In addition, the accretion recorded from amortizing the term loan financing costs to interest expense, increased in the second quarter of 2009 by \$44, and in the first six months of 2009 by \$169, over the same periods in the prior year. The accretion resulted from the GAAP requirement to use the effective interest rate method for financial liabilities stated at amortized cost in order to recognize the expense of the original financing costs, including the initial fair value of the ComVest Warrants.

Finance and bank charges for the six months ended June 30, 2009 include the cost of the waiver provided by ComVest for the March 31, 2009, and December 31, 2008, reporting periods (see “ComVest Agreement” and “Liquidity”).

In addition, the interest income in the six months ended June 30, 2009, was primarily due to accrued interest on the OMDC refundable tax credits.

There was no income tax (recovery) expense recorded for the three months and six months ended June 30, 2009, and 2008. 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 the three months and six months ended June 30, 2009, and 2008, was offset by utilizing an equal portion of the unrecognized operating loss carry-forwards from previous years. As at June 30, 2009, we continue to carry a full valuation allowance against our income tax assets due to the continued uncertainty surrounding their full usage. We will not be required to record income tax expense against earnings in Canada until either all unrecognized operating loss carry-forwards are utilized or expire. As of December 31, 2008, our Canadian loss carry-forwards were approximately \$14,570, of which \$192 expires in 2009, and the balance between 2010 and 2028. Furthermore, we will not be required to record income tax expense against earnings in the US until all unrecognized operating loss carry forwards are utilized or expire. With U.S. operations now discontinued, it is unlikely the Company will be able to utilize these loss carry forwards. As of December 31, 2008, our US loss carry-forwards were approximately \$8,148 and will expire between 2024 and 2028.

For the three months ended June 30, 2009, we recognized a net loss from continuing operations

of \$2,642 or \$0.05 per share, as compared to a net loss of \$1,998, or \$0.04 per share, for the same period in 2008. The increased loss from continuing operations of \$644 was primarily due to the write-off of the un-accreted financing costs.

For the six months ended June 30, 2009, we recognized a net loss from continuing operations of \$2,566 or \$0.05 per share, as compared to a net loss of \$3,642, or \$0.07 per share, for the same period in 2008. The decrease in net loss from continuing operations of \$1,076 was primarily due to an increase in gross margin of \$1,666 (see gross margin discussion above), which included the recognition in 2009 of \$1,473, net of applicable fees, of OMDC refundable tax credits, offset, in part, by the write-off of the un-accreted financing costs.

As a result of the loss recorded for both continuing and discontinued operations in both the three month periods and six month periods ended June 30, 2009, and 2008, potentially dilutive securities become anti-dilutive, and therefore the diluted net loss per share is unchanged from the basic net loss per share for both continued and discontinued operations.

### **Discontinued Operations**

Summarized income statements for the ASA are as follows:

	For the three months ended		For the six months ended	
	June 30		June 30	
	<b>2009</b>	2008	2009	2008
Revenue	\$ 338	\$ 410	\$ 809	\$ 769
Income (loss) before impairment charge	(243)	(339)	(430)	(997)
Impairment charge on capital assets	(50)	-	(50)	-
Net loss from discontinued operations	\$ (293)	\$ (339)	\$ (480)	\$ (997)

Included in the loss from discontinued operations for both the three-month and six-month periods ended June 30, 2009 is a long-lived asset impairment charge of \$50 as a result of recording ASA's capital assets at the lower of carrying value and fair value, less costs to sell. Interest and general corporate overhead have not been allocated to discontinued operations.

Since its incorporation in 2006, ASA has been a subcontractor to the Company on the CFTS project and as required on certain other projects. Revenue earned by ASA on the CFTS project are recorded in continuing operations as a cost of revenue and are eliminated against such revenue in our consolidated results of operations. The revenue recorded in ASA and the corresponding cost of revenue in continuing operations for the three months and six months ended June 30, 2009 and 2008 are as follows:

	Three months ended,		Six months ended,	
	June 30		June 30	
	<b>2009</b>	2008	<b>2009</b>	2008
Revenue of ASA and cost of revenue of ASI	\$ 198	\$ 688	\$ 279	\$ 1,280

For the periods indicated in the above table, ASA performed services on behalf of ASI for the CFTS project only. These revenues of ASA and the corresponding cost of revenue in ASI are excluded (consolidation elimination) from the revenues and gross margin for continuing operations in the Consolidated Statements of Operations, Comprehensive Loss and Deficit. However, the actual cost to perform CFTS related activities in ASA has been included in the cost of revenue for continuing operations.

The Company recognized revenues from discontinued operations from contracts with non-related parties of \$338 (2008: \$410) and \$809 (2008: \$769) and in the three months and six months ended June 30, 2009, respectively. The revenues recorded in 2009 were substantially derived from one contract awarded to ASA from a large U.S. defense contractor in the first quarter of 2008 and completed during the second quarter of 2009. Revenue in 2008 was derived from this contract as well as from two other contracts with the same contractor, both of which were completed in the second half of 2008. As of June 30, 2009, ASA had completed all of its obligations with respect to revenue generating contracts with independent parties and had no corresponding order backlog.

### **Summary of Quarterly Results (unaudited)**

The following are the quarterly results for the Company's eight most recently completed quarters:

	2009		2008				2007	
	30-June \$	31-March \$	31-Dec \$	30-Sept \$	30-June \$	31-March \$	31-Dec \$	30-Sept \$
Revenue	1,992	3,462	2,647	2,124	3,835	3,980	5,161	6,520
Gross margin (deficit)	325	2,296	839	93	438	517	(42)	977
Operating expenses <sup>(1)</sup>	1,423	1,510	2,340	1,674	1,647	1,602	2,043	2,036
Net (loss) income from continuing operations	(2,642)	76	(15,067)	(2,341)	(1,998)	(1,644)	(2,575)	(1,259)
Net loss	(2,935)	(111)	(16,248)	(2,530)	(2,337)	(2,302)	(3,334)	(1,594)
Net loss from continuing operations per share (basic and diluted)	(0.05)	0.00	(0.27)	(0.04)	(0.04)	(0.03)	(0.05)	(0.02)
Net loss per share (basic and diluted)	(0.05)	0.00	(0.29)	(0.05)	(0.04)	(0.04)	(0.06)	(0.03)
CFTS revenues	340	1,055	686	312	1,888	1,789	3,010	4,340
Non-CFTS revenues from continuing operations	1,652	2,407	1,961	1,812	1,947	2,191	2,151	2,180

<sup>(1)</sup> Includes G&A, S&M and stock option expense

The Company has been dependent over each of the last eight quarters on a small number of high-dollar value contracts, and in particular the CFTS program. The initial production phase of this program entered into its mature phase in the third quarter of 2007, and as at the end of the second quarter of 2009 is approximately 98% complete. As a result, quarterly revenues

from continuing operations consistently declined beginning in the third quarter of 2007 and through to the third quarter of 2008, and then declined further in the second quarter of 2009.

The increase in the first quarter of 2009 for the CFTS program reflects positive adjustment to revenue from reconfigured cost estimates to complete this program as well as the increases in forecasted support billings from the application of escalation clauses in the CFTS contract. CFTS revenues in the third and fourth quarters of 2008 and the second quarter of 2009 reflect negative adjustments to revenue from reconfigured cost estimates to complete this program.

The above table illustrates the correlation between quarterly revenues from continuing operations, and the level of CFTS revenues. Quarterly revenues from continuing operations, derived from other than the CFTS program, have been relatively consistent, averaging approximately \$2.0 million for each of the last eight quarters, with the highest recorded at \$2,407 in the first quarter of 2009, and the lowest at \$1,652 in the second quarter of 2009.

The non-CFTS revenues from continuing operations in the second quarter of 2009 were decreased by \$532 due to the affect of fluctuating exchange rates on the revenues from the U.S. denominated SMHP contract, while the non-CFTS revenues in the first quarter of 2009 were increased by \$543 due to revised cost estimates for this program. Quarterly revenues beginning in the fourth quarter of 2007 through the fourth quarter of 2008 include relatively consistent contributions from the SMHP.

The second quarter of 2009 also includes revenues of \$723 from higher margin contracts awarded in 2009 for e-learning programs and the C-130J FTD. The non-CFTS revenues in the second quarter of 2008 were decreased by \$856 (gross margin: \$168) due to revised cost estimates for the RDAF program. Non-CFTS revenue in the third quarter of 2007 includes greater contributions from the RDAF program and the CF weapons load trainers program, prior to entering their mature phase in the third quarter of 2007. In addition, we have generally experienced higher quarterly revenues since the first quarter of 2008 from the energy sector.

The Company has experienced substantial quarterly net losses and quarterly net losses from continuing operations beginning with the third quarter of 2007, as the CFTS project reached maturity.

The net loss and net loss from continuing operations also reflect the effect on gross margin from changes in foreign exchange rates on the SMHP program, and changes in estimates of the cost to complete all major programs, as discussed above.

In addition, the loss in the second quarter of 2009 was increased by the \$594 write-off of the un-accreted financing costs related to the ComVest Term Loan, while the loss in the first quarter of 2009 was decreased by the recognition of \$1,306 of OMDC refundable tax credits, net of applicable fees.

The net losses in the fourth quarter of 2008 and 2007 increased over the other quarters presented as a result of restructuring and severance accruals for overhead and operating

expenses of \$846 (including the effect of reversals in 2008 of amounts accrued in 2007) and \$802 in the fourth quarter of 2008 and 2007, respectively. Included in these amounts are \$45 and \$110 for restructuring and severance accruals in ASA in the fourth quarter of 2008 and 2007, respectively. The fourth quarter of 2008 also includes the write-off of goodwill and the HVTT.

During the first three quarters of 2008, the effect on quarterly losses from decreased quarterly revenues was mitigated by the cumulative effects of the initial cost reduction initiatives and in the first and second quarters of 2009 was further mitigated by further cost reduction initiatives in the fourth quarter of 2008. However, in the last three quarters of 2008, and the first and second quarters of 2009, the effect of cost reduction initiatives was partially offset by an increase in interest expense on the ComVest Term Loan and ComVest Operating Line.

Both the quarterly net loss per share (basic) and the quarterly net loss per share (basic) for continuing operations reflect increases in the number of common shares outstanding. In September, 2007, the Company issued 1,294,498 common shares pursuant to the Eduplus acquisition. No additional common shares were issued in the last two quarters of 2007, fiscal 2008 or in the first and second quarter of 2009. As at June 30, 2009, the number of outstanding common shares was 55,993,929.

For all quarters, both the diluted net loss per share and the diluted net loss per share for continuing operations did not result in any dilution versus the reported basic earnings per share.

## 15. CASH FLOW , LIQUIDITY AND CAPITAL RESOURCES

### Summary

At June 30, 2009, we had bank indebtedness, net of cash, of \$5,647 as compared to bank indebtedness, net of cash, of \$1,116 at June 30, 2008. The sources and uses for the changes in bank indebtedness, net, for the three-months and six months ended June 30, 2009 and 2008, are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Cash flows provided by (used in)				
Operating activities	\$ (265)	\$ (775)	\$ (2,775)	\$ (4,397)
Investing activities	11	(16)	(3)	(36)
Financing activities	(314)	(263)	(635)	(403)
Foreign exchange gain on US\$ Term Loan	(149)	-	(76)	-
Increase in bank indebtedness <sup>(1)</sup>	(717)	(1,054)	(3,489)	(4,836)
Bank indebtedness at beginning of period	(4,930)	(62)	(2,158)	3,720
Bank indebtedness at end of period	\$ (5,647)	\$ (1,116)	\$ (5,647)	\$ (1,116)

(1) For further detail of the components from continuing and discontinued operations, see Consolidated Statements of Cash Flows.

### **Operating Activities**

For the three months ended June 30, 2009, the cash outflows from operating activities of \$265 (2008: \$775) were primarily due to a net loss from operating activities for continuing operation of \$2,642 (2008: \$1,998), which was decreased by non-cash charges of \$1,276 (2008: \$586) from continuing operations and by an inflow of \$1,520 (2008: \$1,359) from the net change in non-cash working capital from continuing operations and increased by a net outflow from discontinued operations of \$409 (2008: a net outflow of \$719). The \$1,520 cash inflow in 2009 from the net changes in non-cash working capital items related to continuing operations was primarily due to a decrease in trade receivables, while the cash outflow in 2008 is primarily due an increase in trade receivables, partially offset by an increase in accounts payable and accrued liabilities.

For the six months ended June 30, 2009, the cash outflows from operating activities of \$2,775 (2008: \$4,397) were due to a net loss of \$2,566 (2008: \$3,642) from continuing operations, which was decreased by non-cash charges of \$1,826 (2008: \$1,103) from continuing operations and increased by an outflow of \$1,237 (2008: \$483) from the net change in non-cash working capital from continuing operations, and further increased by a net outflow from discontinued operations of \$787 (2008: \$1,366). The \$1,237 cash outflow in 2009 from the net changes in non-cash working capital items related to continuing operations was primarily due to an increase in trade receivables and a reduction in accounts payable. The cash outflow in 2008 was primarily due to a decrease in accounts payable and accrued liabilities.

### **Investing Activities**

For the second quarter of 2009, the cash provided by investing activities was \$11 (2008: use of \$16). For the six months ended June 30, 2009 the cash used by investing activities was \$3 (2008: \$36). Both the three-month and six-month period in 2009 include a \$21 inflow from discontinued operations for the proceeds from the disposal of the capital assets of ASA. All periods reflect the expected minimum level of investment in capital assets under our cost reduction initiatives. We expect that our capital expenditures will remain at approximately the same minimal level until business levels increase.

### **Financing Activities**

Cash outflows from financing activities were \$314 (2008: \$263) and \$635 (2008: \$403) for the three months and six months ended June 30, 2009, respectively. All financing activities relate to continuing operations. The cash outflows in 2009 include the scheduled repayment of principal on the outstanding ComVest Term Loan. The cash outflows in 2008 include the scheduled repayment of principal on an old term loan, and subsequent to April, 2008, the outstanding ComVest Term Loan. In addition, the 2008 outflows reflect the repayment of the old term loan with the proceeds received May 5, 2008, from the ComVest Term Loan.

## **16. LIQUIDITY**

Effective April 30, 2008, we entered into financing arrangements with ComVest that provided up

to U.S.\$6.6 million of financing in the form of a secured term loan in the amount of U.S.\$2.6 million at a rate of interest of 12.5% per annum payable monthly and 5% per annum of deferred interest, accrued monthly, payable at maturity. In addition, the ComVest Agreement includes an operating line of up to U.S. \$4.0 million based on a borrowing base at a rate of interest of U.S. prime plus 2% per annum with a floor of 8%. The ComVest Term Loan matures on April 30, 2011 and the ComVest Operating Line will be available until April 30, 2010, subject to a one-year extension at the option of the Company. Pursuant to the ComVest Agreement, the Company issued the ComVest Warrants. (See “ComVest Agreement”).

As at June 30, 2009, \$5,700 (U.S. \$4,901) of the ComVest Operating Line was utilized. The ComVest Agreement provides for a maximum borrowing base, based on the current month trade receivables and unbilled revenue balance, and permits us to borrow funds directly for operating and subsidiary funding purposes. As at June 30, 2009, the Company had exceeded the maximum borrowing limit per the terms of the ComVest Agreement by approximately U.S. \$3,594. The Company had also exceeded the maximum borrowing limit at March 31, 2009, December 31, 2008 and September 30, 2008 by U.S. \$1,398, U.S. \$2,469 and U.S. \$665, respectively.

In addition, the ComVest Agreement contains covenants for minimum requirement of an EBITDA to Fixed Charges ratio and an annual maximum capital expenditure limit. Any advances are repayable on demand. EBITDA is defined in the ComVest Agreement as consolidated net income before interest, taxes, depreciation, amortization and non-cash charges and expenses other than accruals made in the normal course of business, less any dividends on capital distribution. Fixed Charges are defined as the sum of the following: all principal payments scheduled or required to be made during the period with respect to the ComVest Loan; all related interest expense of the period; and all income taxes paid or accrued for that period.

At June 30, 2009 and March 31, 2009, the Company was not in compliance with the covenant included in the ComVest Agreement related to the requirement for the last four quarters of a minimum ratio of EBITDA to Fixed Charges of 1.25 to 1.0. The Company was also not in compliance with the EBITDA covenant at December 31, 2008 (a requirement of a minimum ratio of EBITDA to Fixed Charges of 1.1 to 1.0), September 30, 2008 (a requirement of a nine-month rolling minimum EBITDA of negative \$1.8 million) and June 30, 2008 (a requirement of a six-month rolling minimum EBITDA of negative \$2.0 million).

The Company did not request a waiver for its breach of the EBITDA covenant at June 30, 2009 or for exceeding its maximum borrowing limit for the revolving Line of Credit on June 30, 2009 in order to avoid the waiver fee. As a result of these “in default” conditions, the entire balance of the ComVest Term Loan has been classified as a current liability. The Company had previously anticipated that it would violate covenant requirements at future compliance dates and had therefore previously presented the entire balance of the Term Loan as a current liability.

On March 25, 2009, the Board agreed to re-price, subject to regulatory approval, the ComVest Warrants from \$0.09 to \$0.03 per share. The Company received TSX approval for the re-pricing on April 9, 2009. The warrants were re-priced in lieu of covenant waiver fees that would have been otherwise charged by ComVest for covenant waivers as of December 31, 2008 and March

31, 2009. ComVest had previously agreed to provide waivers without charge for all reporting periods prior to December 31, 2008.

Effective April 1, 2009, ComVest commenced charging additional default interest of 5% per annum on both the Line of Credit and the Term Loan. The floor interest rate for the Line of Credit and the paid-monthly interest rate for the Term Debt would be 13% per annum and 17.5% per annum, respectively, for periods that the Company is in default. The deferred interest rate of 5% per annum for the Term Debt has not changed.

The Company is currently dependent on ComVest's support and the loss of ComVest's support in the near term would likely result in the Company being unable to continue operations. Any attempt by the Company to arrange financing to replace the ComVest Agreement would require the approval and interim cooperation of ComVest. The Company is currently engaged in further discussions with ComVest on future financing and covenant requirements.

On April 15, 2009, the Company received a partial payment for OMDC refundable tax credits of approximately \$1,306, net of applicable fees, and on May 15, 2009 received the balance of \$167, net of applicable fees.

The Company's stock price on the TSX had declined substantially in the past eight quarters and its closing price at August 13, 2009 was \$xx. As a result, the Company is currently dependent on its lenders, cash generated from current and new projects, and refundable investment tax credits for its liquidity.

## 17. CAPITAL RESOURCES

### Stock Options

During the quarter ended June 30, 2009, the Company awarded 1,000,000 options to purchase common shares of the Company under our stock option plan (the "Plan"). The options are exercisable at \$0.04 per share for a term of five years and fully vest within 180 days of the date of the grant.

No options were exercised during 2009 and 1,357,414 and 1,917,213 stock options were either cancelled or expired during the three months and six months ended June 30, 2009, respectively.

As at June 30, 2009, based on the actual number of common shares outstanding, the Plan would allow for the issuance of a total of 8,399,089 options to purchase common shares of our Company. There are currently 6,989,694 options to purchase common shares outstanding, leaving 1,409,395 options available for issuance under the Plan. The amount of options available for issuance will change as we grant options and as the actual number of common shares outstanding changes as well.

During the three months and six months ended June 30, 2009, the Company recorded a net stock option compensation expense of \$43 (2008 - \$36) and \$96 (2008 - \$72), respectively, for the combination of the vesting of existing options, the grant of new options and the

recognition of options cancelled. The calculation of the compensation expense includes determining the fair value of each option as calculated on the date of the grant using the Black-Scholes option pricing model.

### Warrants

On March 25, 2009, the Board agreed to re-price the ComVest Warrants, subject to regulatory approval, from \$0.09 to \$0.03 per share. The expense related to re-pricing these warrants was credited to warrants within the share capital account. In the six months ended June 30, 2009, no common share purchase warrants were exercised or expired. As at June 30, 2009, 9,300,000 warrants were outstanding at an exercise price of \$0.03 per share.

### Contributed Surplus

Our contributed surplus as at June 30, 2009, increased by \$96 to \$9,296 from December 31, 2008 as a result of the stock option compensation expense recognized in the Consolidated Statement of Operations.

## 18. OUTSTANDING SHARE DATA

The following table summarizes the changes in the common shares, common share purchase warrants and options to purchase common shares from December 31, 2008 to July 31, 2009.

	<b>Common Shares</b>	<b>Warrants<sup>(1)</sup></b>	<b>Options</b>
<b>Outstanding at December 31, 2008</b>	55,993,929	9,300,000	7,906,907
<b>Issued / Exercised</b>	-	-	1,000,000
<b>Granted</b>	-	-	-
<b>Cancelled / Expired</b>	-	-	(2,553,512)
<b>Outstanding at July 31, 2009</b>	<b>55,993,929</b>	<b>9,300,000</b>	<b>6,353,395</b>

<sup>(1)</sup> See “Capital Resources – Warrants”.

As at July 31, 2009, there were 9,300,000 common share purchase warrants outstanding at an exercise price of \$0.03 per share.

As at July 31, 2009, there were 6,989,694 stock options outstanding at exercise prices ranging from \$0.02 to \$0.68 with expiry dates from January 20, 2010 through June 28, 2012.

## 19. COMMITMENTS AND CONTINGENCIES

Pursuant to the agreement of purchase and sale between Tecresult and the Company, under which we purchased the Eduplus assets from Tecresult on September 27, 2007, the two parties entered into a teaming agreement which established certain rights and obligations going forward for both parties. In addition, the Company was obligated to pay up to \$500 for future milestone based payments, on a cash neutral basis, equivalent to the gross margin on payments received by the Company for the Sikorsky Marine Helicopter Program contract that was assumed with the Eduplus acquisition.

The Company received a demand letter from Tecsuit's counsel demanding \$500 plus interest pursuant to these provisions of the teaming agreement. The Company has negotiated a settlement, awaiting execution by both parties, which will see future payments made by Sikorsky paid into escrow until the final settlement amount, not to exceed \$450, is paid in full. Under the terms of the settlement, for each payment made by Sikorsky Aircraft Corporation into the escrow account, 10% of the amount will be paid to Tecsuit, and the remainder to the Company. In addition, an amount of \$39 would be payable to Tecsuit on execution of the settlement agreement, which represents 10% of payments received by the Company from Sikorsky subsequent to the parties reaching a verbal agreement in November 2008. An additional amount of \$28 would be payable on execution of the settlement agreement pursuant to the purchase price adjustments in the original agreement of purchase and sale.

## 20. USE OF FINANCIAL DERIVATIVES

We may use foreign exchange forward contracts to manage exposures created when sales and purchases are made in foreign currencies. As at June 30, 2009, there were no foreign exchange forward contracts outstanding (December 31, 2008 - nil).

We have not used derivative instruments to reduce our exposure to interest rate risk or to change our exposure from fixed to floating interest rates.

## 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 for consultants and professional service providers.

The Company incurred costs of \$61 (2008 - \$25) during the first quarter of 2009 for legal services provided by Gowling Henderson Lafleur LLP ("Gowlings"), a law firm in which a former director of the Company is a partner. The former director resigned from the Board effective March 19, 2009. The Company incurred further costs of \$22 with Gowlings in the second quarter of 2009, and as at June 30, 2009, has an outstanding balance payable to Gowlings of \$107. This amount is included in accounts payable and accrued liabilities.

In addition, the Company recorded expenses, including related costs, of \$119 (2008 - nil) and \$194 (2008 - nil), during the three months and six months ended June 30, 2009, respectively, for consulting services provided by CEO Capital Corporation. ("CEO Capital"). A director of the Company is a principal shareholder of CEO Capital. CEO Capital provides consulting services, pursuant to a consulting agreement with the Company, principally in the areas of corporate strategy, capital restructuring and business development. The consulting agreement, which commenced in July 2008 for a term of one year, calls for a fee of \$25 per month plus expenses. An amount of \$44 for ongoing expenses of CEO Capital was paid and expensed in the second quarter of 2009. In the event CEO Capital earns a fee on a future financing or capital related transaction with respect to the Company, the expense would be deducted from such fees.

During 2008, pursuant to this consulting agreement, the Company granted 2,000,000 options to CEO Capital at an exercise price of \$0.02 per share. The amortization of the fair value of these options is not otherwise reflected in this section and has been included in stock option expense for the three months and six months ended June 30, 2009.

On September 16, 2008, the Board approved the reimbursement of \$90 of consulting fee expenditures to CEO Capital. This amount was paid in six equal monthly instalments commencing in October 2008 and is pursuant to the consulting agreement with CEO Capital. As at June 30, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in July, 2009.

The Company incurred expenses of \$19 (2008 - nil) and \$29 (2008 - nil), during the three months and six months ended June 30, 2009, respectively, for investor-relations services provided by Breakthrough Growth Corporation (“Breakthrough”). A director of the Company has a controlling interest in Breakthrough. The Company entered into a one-year investor-relations contract with Breakthrough effective February 1, 2009 for \$5 per month plus expenses. As at June 30, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in July 2009.

The Company also incurred expenses related to a corporate strategy session of \$6 to an organization in which a director of the Company has a controlling interest, and paid annual fees of \$6 on behalf of the interim CEO of the Company to the Presidents of Enterprising Organizations, an organization of which a director of the Company is a principal.

In addition, in February, 2009, the Company incurred a onetime charge of \$31 for consulting services from Harborview Advisors LLC in which a director of the Company is a principal.

All related party costs have been recorded to general and administrative expense. No amounts were payable as of June 30, 2009 to any of the Company’s current related parties.

## 22. SUBSEQUENT EVENTS

Pursuant to its notification on July 12, 2009, the Company’s common shares were to be delisted on the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review. (note 2).

On July 7, 2009, the Company and its landlord executed a Stand Still Agreement (see “Cost Reduction Initiatives”).

On July 14, 2009, the Company, CEO Capital and ComVest entered into an inter-creditor agreement, whereby the parties agreed to the following: ComVest agreed to share its collateral on the ComVest loans to the Company with bridge loans provided by CEO Capital for up to \$1,500; all parties agreed as to the priority of scheduled repayments; and CEO Capital agreed to provide ComVest with an 120 day cure period in the event of default. On July 14, 2009, CEO Capital provided a \$250 bridge loan to the Company, secured by a promissory note. The

promissory note is due on November 11, 2009, plus the accrued interest at 2% per month, unless the due date is extended at CEO Capital's sole option. The interest rate is invariant with respect to default conditions.

In July 2009, the Company reached an agreement with a U.S. based company to transfer our qualification rights to bid as a contractor with the U.S. Army under STOC II. We have received an irrevocable payment of \$130 for completing a written submission to the U.S. Government to transfer these rights ("Novation Request"). An additional \$130 would be due providing that the Novation Request is approved by the U.S. Government (see "Discontinued Operations").

The Company did not request a waiver with respect to its non-compliance with certain terms of the ComVest Agreement for the reporting period ended June 30, 2009 in order to avoid the waiver fee (see "ComVest" and Liquidity").

Also see "Highlights and Summary – Recent Developments".

## 23. ACCOUNTING POLICY DEVELOPMENTS

The Company had previously adopted and is now utilizing the recommendations in Section 3475, Disposal of Long-Lived Assets and Discontinued Operations, of the Institute of Chartered Accountants ("CICA") Handbook which establishes revised standards for the recognition, measurement, presentation and disclosure of disposal of long-lived assets. The Company also adopted the recommendations of Abstract 161 of the Emerging Issues Committee ("EIC") of the CICA with respect to the allocation of interest expense and overhead to discontinued operations.

On January 1, 2009, the Company adopted the recommendations in Section 3064, Goodwill and Intangibles, of the Institute of Chartered Accountants ("CICA") Handbook which establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company also adopted the amendments to CICA Handbook Section 1000, Financial Statement Concepts, which was amended to provide consistency with Section 3064. The adoption of these amendments did not have an impact on the Company's financial results.

On January 1, 2009, the Company adopted the recommendations in Section 1400, General Standards on Financial Statement Presentation, of the CICA Handbook which has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern.

### **Recently issued accounting standards**

#### IFRS Conversion Plan

On February 13, 2008, the Canadian Accounting Standards Board ("AcSB") confirmed the mandatory International Financial Reporting Standards ("IFRS") changeover date for Canadian profit-oriented publicly accountable entities ("PAEs"). This means that PAEs will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require restatement for comparative purposes of amounts reported by the Company for annual

and interim periods for the year ended December 31, 2010.

Canadian GAAP will be converged with IFRS through a combination of two methods: as current joint-convergence projects of the U.S. Financial Accounting Standards Board and the International Accounting Standards Board (“IASB”) are agreed upon, they will be adopted by the ACSB and may be introduced in Canada before the complete changeover to IFRS; and standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the complete changeover to IFRS. The IASB currently, and expectedly, has projects underway that should result in new pronouncements that continue to evolve IFRS.

On May 9, 2008, the Canadian Securities Administrators (“CSA”) released Staff Notice 53-320, Disclosure of Expected Changes in Accounting Policies Relating to the Changeover to International Financial Reporting Standards. The Staff Notice addresses disclosure in the MD&A for all PAEs for interim and annual periods beginning three years before the changeover to IFRS.

The following update with respect to the status of our transition to IFRS should be read in conjunction with the detailed plan in the Company’s annual MD&A for 2008. The Company had disclosed in its annual MD&A for 2008 the following events it expected to have completed or underway by June 30, 2009:

<b>Task</b>	<b>Status as of July 31, 2009</b>
<ul style="list-style-type: none"> <li>• Complete our planning to ensure sufficient internal expertise</li> </ul>	<ul style="list-style-type: none"> <li>• Complete</li> </ul>
<ul style="list-style-type: none"> <li>• Commence senior finance training</li> </ul>	<ul style="list-style-type: none"> <li>• CFO has completed a four day IFRS course, Corporate Controller enrolled in an IFRS course in third quarter of 2009</li> </ul>
<ul style="list-style-type: none"> <li>• Complete the identification of all relevant GAAP-dependant covenants and contracts</li> </ul>	<ul style="list-style-type: none"> <li>• Scheduled to be completed in the third quarter of 2009</li> </ul>
<ul style="list-style-type: none"> <li>• Commence evaluation of all differences in IFRS GAAP to Canadian GAAP</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluation is in early stages, scheduled completion is now November 30, 2009</li> </ul>
<ul style="list-style-type: none"> <li>• Identification and assembly of the accounting policies rewrite team</li> </ul>	<ul style="list-style-type: none"> <li>• Team is identified, however, no team activities to date</li> </ul>

We believe that we have generally fallen behind our disclosed IFRS conversion schedule. However, we expect to be back on this schedule by December 31, 2009.

#### Other

In January 2009, the CICA issued Handbook Section 1582, Business Combinations, which replaces the existing standards. This section establishes the standards for the accounting of

business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to International Financial Reporting Standards on business combinations. This standard is applied prospectively to business combinations with acquisition dates on or after April 1, 2011. Earlier adoption is permitted. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

In January 2009, the CICA issued Handbook Section 1602, Non-controlling Interests, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to International Financial Reporting Standards on consolidated and separate financial statements. This standard is effective for our fiscal periods beginning April 1, 2011. Earlier adoption is permitted. The Company believes that adopting this standard will not have an impact on its consolidated financial statements.

In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for our fiscal periods beginning April 1, 2011. Earlier adoption is permitted. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

In January 2009, the CICA issued EIC 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which clarifies that the credit risk of the entity and the counterparties should be taken into account in determining the fair value of financial instruments, including derivative financial instruments. EIC 173 is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of EIC 173. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

## 24. 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, intangible assets and goodwill, and the fair value of debt instruments, 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.

## 25. BUSINESS OUTLOOK

The following contains forward-looking statements about our business outlook for the remainder of 2009. Reference should be made to “Forward-Looking Statements” on page 6. 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 the MD&A for the year ended December 31, 2008 and the Description of the Business – Risk Factors section in our Annual Information Form.

Our liquidity and ability to continue operations as currently constituted will depend on the continuing support of our lenders, the timing of recognition of our current backlog and new customer orders.

Assuming adequate liquidity, our performance in the remainder of 2009 will be determined by the uncertain timing of the award of military training contracts, our ability to expand on our initial penetration into the Canadian energy industry, and our ability to quickly leverage our new strategy to address our customers’ full value chain, not just their training requirements.

Our short term profitability will also be affected by our low order backlog now that the initial production phase of the CFTS and RDAF programs are substantially complete. The SMHP is expected to be completed in 2011. The programs resulting from recently secured contacts with CAE, L-3 MAPPS and the DND are in the early stages of revenue generation.

In terms of specific results for remainder of fiscal 2009, we expect that:

- We will continue to implement our new strategic focus to broaden the value we provide to our existing customer base and develop our strategic account management approach to selling. We anticipate with this strategy that we will have greater success in landing substantial new contracts than in recent years.
- As at June 30, 2009, approximately \$1.4 million of revenue remained to be recognized for the initial phase of the CFTS project. We expect that substantially all of this amount will be recognized in the remainder of 2009.
- We believe that the CFTS program has contributed significantly to our intellectual property and has enhanced our ability to handle large and complex learning systems. In addition, our participation in the program greatly enhances our ability to capture significant new business that will flow from the CFTS program in the form of enhancements to the existing program and new procurement programs. As a result, we believe that opportunities related to the CFTS program with the CF and DND will continue to be a significant contributor to our Company’s revenue base for the foreseeable future due to planned and projected upgrades, enhancements and improvements to the training procedures and technologies required by the CF throughout the life cycle of the program. Recently, our senior management team visited the Southport facilities and met with the Allied Wings management team as part of our ongoing effort to deepen relationships with our strategic accounts. During this visit it became further apparent that there is a potential for a significant recurring revenue stream

from the CFTS program available to Atlantis, including courseware refresh and upgrades and new flight training devices.

- Gross margins will continue to fluctuate and will depend on our future revenue levels, changes in estimates to complete large customer programs, the relative strength of the Canadian dollar to the U.S. dollar, our ability to manage non-variable overhead costs and the margin levels attainable for anticipated new business.
- G&A and S&M expenses will decrease further in 2009 from the levels experienced in fiscal 2008 as a result of our 2007 cost reduction plan, subsequent cost reduction initiatives in 2008 and 2009 and further reductions anticipated in 2009.
- Interest expense and financing costs will increase over 2008 levels due to the outstanding ComVest Term Loan, the increased borrowings on the outstanding ComVest Operating Line, and the additional default interest rate of 5% which became effective, April 1, 2009 on both these instruments.
- Capital expenditures, without giving effect to any assets acquired in acquisitions, are expected to be lower than 2008 levels until business levels increase.
- Cash balances are expected to generally decline as additional losses are anticipated for 2009. Cash availability to fund future operations will depend on the Company's ability to secure new orders, continued support from ComVest, and our ability to secure additional capital.
- Future unanticipated outflows and out of covenant events that may not be waived by ComVest may result in our need to complete additional financings. Access to such capital at acceptable commercial terms for a company of our size and financial status will be greatly dependent on our ability to increase our backlog position, demonstrate execution of our business strategy and the general condition of the credit markets and may be significantly dilutive to existing shareholders. The Company's access to credit or capital could be further restricted by the current global financial crisis which has restricted credit worldwide. The Company's access could be further restricted by its August 19, 2009 delisting by the TSX. Should the Company not be able to secure additional financing, it is unlikely the Company will be able to continue operations as presently constituted (see – "Going Concern").

## 26. 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 pursuant to National Instrument 52-109. 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 June 30, 2009.

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 have concluded that the Company's internal controls for financial reporting ("ICFR") are operationally effective, although they do not expect that these internal controls will prevent all error and all fraud. The Company's CEO and CFO have based their conclusion on the operational effectiveness of its ICFR on the results of a substantial internal review and testing process completed in the first quarter of fiscal 2009. However, 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.

During the three months ended June 30, 2009, there have been no changes in our Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our Company's internal control over financial reporting. However, in order to conserve cash, the Company has eliminated quarterly audit reviews beginning with the first quarter of 2009.

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](http://www.sedar.com).

August 14, 2009

*Interim Consolidated Financial Statements of*

**ATLANTIS SYSTEMS CORP.**

*June 30, 2009 and 2008*

**ATLANTIS SYSTEMS CORP.**  
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**June 30, 2009 and 2008**

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**ATLANTIS SYSTEMS CORP.****Consolidated Statements of Operations, Comprehensive Loss and Deficit****For the three and six months ended June 30****(Expressed in thousands of Canadian dollars except per share amounts)****(unaudited)**

	For the three months ended June 30		For the six months ended June 30	
	2009	2008	2009	2008
Revenue (notes 6, 7, 18 and 19)	\$ 1,992	\$ 3,835	\$ 5,454	\$ 7,815
Cost of revenue (note 6)	1,667	3,397	2,833	6,860
Gross margin	325	438	2,621	955
Expenses				
General and administrative	1,120	1,216	2,167	2,441
Selling and marketing	260	395	670	736
Stock options	43	36	96	72
	1,423	1,647	2,933	3,249
Operating income loss before the undernoted items	(1,098)	(1,209)	(312)	(2,294)
Depreciation and amortization	359	480	715	961
Write-off of mortgage receivable (note 8)	167	-	167	-
Interest and financing costs, net (note 11)	1,018	309	1,372	387
Net loss from continuing operations	(2,642)	(1,998)	(2,566)	(3,642)
Net loss from discontinued operations (note 6)	(293)	(339)	(480)	(997)
Net loss and comprehensive loss	(2,935)	(2,337)	(3,046)	(4,639)
Deficit, beginning of period	(102,491)	(81,265)	(102,380)	(78,963)
Deficit, end of period	\$ (105,426)	\$ (83,602)	\$ (105,426)	\$ (83,602)
Net loss per share (note 16)				
Basic and diluted:				
Continuing operations	\$ (0.05)	\$ (0.04)	\$ (0.05)	\$ (0.07)
Discontinued operations	(0.01)	(0.01)	(0.01)	(0.02)
Net loss	(0.05)	(0.04)	(0.05)	(0.08)
Weighted average number of shares				
Basic and diluted	55,993,929	55,993,929	55,993,929	55,993,929

**ATLANTIS SYSTEMS CORP.**  
**Consolidated Balance Sheets**  
As at June 30, 2009 and December 31, 2008  
(Expressed in thousands of Canadian dollars)

	2009 (unaudited)	2008 (audited)
<b>ASSETS</b>		
Current assets		
Cash	\$ 50	\$ 1,041
Trade receivables (note 7)	1,612	503
Unbilled revenue (note 7)	2,416	1,571
Inventory	443	315
Prepaid expenses	211	242
Current assets of discontinued operations (note 6)	271	191
	<b>5,003</b>	<b>3,863</b>
Capital assets, net		
Long-term prepaid expenses	826	976
Other long-term assets	66	57
Mortgage receivable (note 8)	77	77
Deferred development costs and core technology, net (note 10)	-	164
Capital assets of discontinued operations (note 6)	1,328	1,859
	-	168
	<b>2,297</b>	<b>3,301</b>
	<b>\$ 7,300</b>	<b>\$ 7,164</b>
<b>LIABILITIES</b>		
Current liabilities		
Operating line of credit (note 12)	\$ 5,700	\$ 3,258
Accounts payable and accrued liabilities	3,686	3,238
Accrued costs on percentage completion	507	424
Deferred revenue	1,273	990
Term debt (notes 11, 12, 14 and 16)	2,318	2,197
Current liabilities of discontinued operations	39	347
	<b>13,523</b>	<b>10,454</b>
<b>SHAREHOLDERS' DEFICIENCY</b>		
Share capital and warrants (notes 13 and 14)	89,907	89,890
Contributed surplus	9,296	9,200
Deficit	(105,426)	(102,380)
	<b>(6,223)</b>	<b>(3,290)</b>
	<b>\$ 7,300</b>	<b>\$ 7,164</b>

On behalf of the Board:

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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

**ATLANTIS SYSTEMS CORP.**
**Consolidated Statements of Cash Flows**
**For the three and months ended June 30, 2009 and 2008**
**(Expressed in thousands of Canadian dollars)**
**(unaudited)**

	For the three months ended June 30		For the six months ended June 30	
	2009	2008	2009	2008
Cash flows provided by (used in) :				
<b>Operating activities :</b>				
Net loss	\$ (2,935)	\$ (2,337)	\$ (3,046)	\$ (4,639)
Net loss from discontinued operations	(293)	(339)	(480)	(997)
Net loss from continuing operations	(2,642)	(1,998)	(2,566)	(3,642)
Items not affecting cash:				
Depreciation and amortization	359	480	715	961
Write-off of mortgage receivable	167	-	167	-
Stock options expensed	43	36	96	72
Accretion on term debt	113	70	238	70
Write-off of un-accreted financing costs	594	-	594	-
Financing costs related to re-pricing of common share purchase warrants	-	-	16	-
	(1,366)	(1,412)	(740)	(2,539)
Interest on mortgage receivable	(1)	(4)	(3)	(8)
Long-term prepaid expenses	(10)	1	(9)	(1)
Net change in non-cash working capital (note 20)	1,520	1,359	(1,237)	(483)
Cash provided by (used in) discontinued operations	(409)	(719)	(787)	(1,366)
	(265)	(775)	(2,775)	(4,397)
<b>Investing activities :</b>				
Investment in capital assets	(10)	-	(24)	(20)
Cash provided by discontinued operations	21	(16)	21	(16)
	11	(16)	(3)	(36)
<b>Financing activities :</b>				
Term debt repayment	-	(2,520)	-	(2,660)
Term debt proceeds	-	2,257	-	2,257
Principal payment on term debt	(314)	-	(635)	-
	(314)	(263)	(635)	(403)
Net cash provided by foreign exchange loss on term debt	(149)	-	(76)	-
Net decrease in cash	(717)	(1,054)	(3,489)	(4,836)
Bank indebtedness, net, beginning of period - continuing operations	(4,946)	(217)	(2,217)	3,605
Cash, beginning of period - discontinued operations	16	155	59	115
Bank indebtedness, net, end of period	\$ (5,647)	\$ (1,116)	\$ (5,647)	\$ (1,116)
Bank indebtedness, net, end of period - continuing operations	(5,650)	(1,156)	(5,650)	(1,156)
Cash, end of period - discontinued operations	3	40	3	40
<b>SUPPLEMENTAL INFORMATION</b>				
Bank indebtedness, net for continuing operations is comprised of:				
Cash	\$ 50	\$ 883	\$ 50	\$ 883
Bank operating line of credit	(5,700)	(2,039)	(5,700)	(2,039)
Cash equivalents	3	40	3	40
	\$ (5,647)	\$ (1,116)	\$ (5,647)	\$ (1,116)
Interest paid	\$ 296	\$ 124	\$ 507	\$ 172
Income taxes paid	\$ -	\$ -	\$ -	\$ -

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

# **ATLANTIS SYSTEMS CORP.**

## **Notes to the Interim (Unaudited) Consolidated Financial Statements**

**June 30, 2009 and 2008**

**(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)**

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### **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). The Toronto Stock Exchange has announced that the Company will be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review. Atlantis Systems International Inc. ("ASI") became the sole operating subsidiary of the Company on June 30, 2009 when the Company discontinued the operations of Atlantis Systems America Inc. ("ASA"), effective June 30, 2009 (note 6). 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 the customers. ASA provided similar services in the United States. In addition, the Company has an 85% interest in Denbridge Digital Limited, which is an inactive holding company.

During the second quarter of 2009, the Board of Directors of the Company ("Board") concluded that the future opportunities for ASA were not sufficient to allow the U.S. subsidiary to become self-sustaining. On this basis the Board set an effective date of June 30, 2009, to discontinue U.S. operations. Subsequently, and independent of the decision to discontinue U.S. operations, the Company sold the capital assets of ASA to a third parties.

As a result, the remaining current assets and liabilities of ASA have been segregated and presented separately as discontinued on the consolidated balance sheet as at June 30, 2009, and all assets and liabilities of ASA have been segregated and presented separately as discontinued on the consolidated balance sheet as at June 30, 2008. The results of operations and cash flows of ASA have been segregated and presented separately as discontinued in the consolidated statements of operations, comprehensive loss and deficit and the consolidated statements of cash flows for the three months and six months ended June 30, 2009 and 2008 ( notes 3 and 6).

### **2. GOING CONCERN ASSUMPTION**

These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to meet its commitments, realize its assets and discharge its liabilities in the normal course of business.

For the six months ended June 30, 2009 the Company incurred a net loss of \$3,046 and has a working capital deficiency of \$8,520, a deficit of \$105,426 and a shareholders' deficiency of \$6,223 as at June 30, 2009. This casts substantial doubt on the Company's ability to continue as a going concern. Continuation of the Company as a going concern is dependent upon achieving profitable operations, and/or the ability of the Company to obtain additional financing when necessary.

In addition, On December 12, 2008, the TSX placed the Company under a delisting review, pursuant to Part VII of the TSX Company Manual, as a result of a decline in the market value of the Company's shares and concerns with the Company's financial condition. The Company was reviewed under the TSX's remedial review process and was initially granted 120 days to comply with all requirements for continued listing. After reviewing the Company's submission dated April 5, 2009, the Listing Committee of the TSX informed the Company on April 9, 2009 that the TSX

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had determined to defer its delisting decision until July 3, 2009. After considering the Company's further submission, dated June 29, 2009, the TSX notified the Company that its continuing listing deficiencies had not been rectified. The Company's common shares were to be delisted on the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009. The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review.

If the going concern assumption were not appropriate for these financial statements, adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications used.

In the opinion of management, all adjustments considered necessary for fair presentation of the Company's financial position, results of operations and cash flows have been included. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for any future periods.

**3. ACCOUNTING POLICY WITH RESPECT TO DISCONTINUED OPERATIONS**

The Company had previously adopted the recommendations in Section 3475, Disposal of Long-Lived Assets and Discontinued Operations, of the Institute of Chartered Accountants ("CICA") Handbook which establishes revised standards for the recognition, measurement, presentation and disclosure of disposal of long-lived assets. The Company also adopted the recommendations of Abstract 161 of the Emerging Issues Committee ("EIC") of the CICA with respect to the allocation of interest expense and overhead to discontinued operations.

**4. CHANGE IN ACCOUNTING POLICIES**

*Goodwill and Intangibles*

On January 1, 2009, the Company adopted the recommendations in Section 3064, Goodwill and Intangibles, of the Institute of Chartered Accountants ("CICA") Handbook which establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company also adopted the amendments to CICA Handbook Section 1000, Financial Statement Concepts, which was amended to provide consistency with Section 3064. The adoption of these amendments did not have an impact on the Company's financial results.

*General Standards on Financial Statement Presentation*

On January 1, 2009, the Company adopted the recommendations in Section 1400, General Standards on Financial Statement Presentation, of the CICA Handbook, which has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern.

**5. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

*Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*

In January 2009, the CICA issued EIC 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which clarifies that the credit risk of the entity and the counterparties should be

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taken into account in determining the fair value of financial instruments, including derivative financial instruments. EIC 173 is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of EIC 173. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

*International Financial Reporting Standards*

On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed the mandatory International Financial Reporting Standards (“IFRS”) changeover date for Canadian profit-oriented publicly accountable entities (“PAEs”). This means that PAEs will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require restatement for comparative purposes of amounts reported by the Company for annual and interim periods for the year ended December 31, 2010.

*Business combinations*

In January 2009, the CICA issued Handbook Section 1582, Business Combinations, which replaces the existing standards. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to International Financial Reporting Standards on business combinations. This standard is applied prospectively to business combinations with acquisition dates on or after April 1, 2011. Earlier adoption is permitted. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

*Non-controlling interests*

In January 2009, the CICA issued Handbook Section 1602, Non-controlling Interests, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to International Financial Reporting Standards on consolidated and separate financial statements. This standard is effective for our fiscal periods beginning April 1, 2011. Earlier adoption is permitted. The Company believes that adopting this standard will have no effect on its consolidated financial statements.

*Consolidated financial statements*

In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for our fiscal periods beginning April 1, 2011. Earlier adoption is permitted. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

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**6. DISCONTINUED OPERATIONS**

During the second quarter of 2009, the Board concluded that the future opportunities for ASA were not sufficient to allow the U.S. subsidiary to become self-sustaining. On this basis the Board set an effective date of June 30, 2009, to discontinue U.S. operations. Subsequently, and independent of the decision to discontinue U.S. operations, the Company sold the capital assets of ASA for \$21 to U.S. based third parties.

At the time of the Board's decision, ASA had completed all external revenue generating contracts and its only current remaining revenue generating activities were on behalf of ASI. ASA had provided notice of its intention to not renew the lease on its rental premises, which expired on June 30, 2009.

ASA had previously been qualified by the U.S. Army Program Executive Office for Simulation, Training and Instrumentation as a contractor under STOC II. STOC II is an indefinite delivery/indefinite quantity contracting vehicle that was created to quickly procure the next generation of simulation and training products for use by the U.S. and coalition service members. ASA's qualification provided it with the opportunity to bid on contracts with the U.S. Army. In July, 2009 we agreed to transfer this right to a U.S. based third party in accordance with U.S. Government procedures for addressing such transfers (note 22).

Summarized income statements for ASA are as follows:

	For the three months ended		For the six months ended	
	June 30		June 30	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Revenue	\$ 338	\$ 410	\$ 809	\$ 769
Loss before impairment charge	(243)	(339)	(430)	(997)
Impairment charge on capital assets	(50)	-	(50)	-
Net loss from discontinued operations	\$ (293)	\$ (339)	\$ (480)	\$ (997)

Included in the loss from discontinued operations for both the three month and six periods ended June 30, 2009 is a long-lived asset impairment charge of \$50 as a result of recording ASA's capital assets at the lower of carrying value and fair value, less costs to sell. The assets were subsequently sold at their decreased carrying value.

**ATLANTIS SYSTEMS CORP.**  
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Summarized balance sheet information for discontinued operations is as follows:

	<b>June 30, 2009</b>	December 31, 2008
<b>Current assets</b>		
Cash	\$ 3	\$ 59
Trade receivables	247	72
Prepaid expenses	21	84
<b>Current assets of discontinued operations</b>	<b>\$ 271</b>	<b>\$ 215</b>
<b>Capital assets, net, of discontinued operations (note 9)</b>	<b>\$ -</b>	<b>\$ 144</b>
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 39	\$ 133
Deferred revenue		214
<b>Current liabilities of discontinued operations</b>	<b>\$ 39</b>	<b>\$ 347</b>

Excluded in accounts payable of discontinued operations is \$8,230 (December 31, 2008 – \$7,565) payable to the Company.

See note 19 for segmented information with respect to discontinued operations.

**7. CONCENTRATION OF CREDIT RISK**

The Company has contracts with many customers; however, as at June 30, 2009, three customers from continuing operations represented 53%, 14% and 12% of consolidated trade receivables and unbilled revenue (June 30, 2008 – 16%, nil and 38%, respectively). A fourth customer represented 30% (2008 – 45%), while the second customer represented 17% (2008 – nil) of consolidated revenue for the three months ended June 30, 2009. For the six months ended June 30, 2009, the fourth and first customer represented 30% (2008 – 43%) and 20% (2008 – 14%), respectively, of consolidated revenue. In addition, revenues from discontinued operations include revenue from a U.S. defense contractor which represented 14% (2008 – 10%) and 13% (2008 – 9%) of consolidated revenue for the three months and six months ended June 30, 2009, respectively.

**8. MORTGAGE RECEIVABLE**

On July 7, 2009, the Company reached an agreement (the “Stand Still Agreement”) with its landlord at the Company’s Brampton, Ontario location whereby the Company can continue to defer certain past due rental payments until December 31, 2009, provided that monthly payments are current for July, 2009 and through to the end of December 31, 2009 (the “Stand Still Period”).

Under the terms of the Stand Still Agreement, the Company has forfeited its right to the final mortgage payment of \$200, due December 1, 2013. This mortgage, which has now been deregistered, was pursuant to a sale-leaseback arrangement that the Company entered into with its

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landlord in 1998. The mortgage receivable, which had been discounted at a rate of 9%, was written-off in the second quarter of 2009.

The terms of the Stand Still Agreement further provide that if the Company continues to comply with the terms of the Stand Still Agreement, as well as the original lease agreement, the landlord will credit an amount of \$200 towards the rent payable for the final two months of the lease. The lease expires on November 30, 2013.

**9. CAPITAL ASSETS**

Capital assets for continuing operations consist of the following:

	<b>June 30, 2009</b>		
	<b>Cost</b>	<b>Accumulated Depreciation and Amortization</b>	<b>Net Book Value</b>
Equipment, software, furniture and fixtures	2,623	1,946	677
Leasehold improvements	636	487	149
	<b>3,259</b>	<b>2,433</b>	<b>826</b>

  

	December 31, 2008		
	Cost	Accumulated Depreciation and Amortization	Net Book Value
Equipment, software, furniture and fixtures	\$ 2,589	\$ 1,814	\$ 775
Leasehold improvements	635	434	201
	<b>\$ 3,224</b>	<b>\$ 2,248</b>	<b>\$ 976</b>

Capital assets for discontinued operations as at June 30, 2009 are nil. The equipment, software and furniture and fixtures were sold for proceeds equal to the carrying value. An asset impairment charge of \$50 was recorded prior to the sale. The leasehold improvements were fully depreciated as ASA's lease expired on June 30, 2009.

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Capital assets for discontinued operations as at December 31, 2008 consist of the following:

	December 31, 2008		
	Cost	Accumulated Depreciation and Amortization	Net Book Value
Equipment, software, furniture and fixtures	463	326	137
Leasehold improvements	16	9	7
	\$ 479	\$ 335	\$ 144

**10. DEFERRED DEVELOPMENT COSTS AND CORE TECHNOLOGY**

The following table summarizes the value of assets included in deferred development costs for continuing operations:

	June 30, 2009			
	Cost	Accumulated Amortization	Impairment Loss	Net Book Value
Eduplus core technology	<b>3,188</b>	<b>1,860</b>	-	<b>1,328</b>

  

	December 31, 2008			
	Cost	Accumulated Amortization	Impairment Loss	Net Book Value
Eduplus core technology	3,188	1,329	-	1,859

Eduplus core technology is software that was acquired in the purchase of the Eduplus division of Tecsult Inc. ("Tecsult") on September 27, 2007, and is being amortized over three years. Amortization for the three months and six months ended June 30, 2009 was \$266 (2008 - \$266) and \$531 (2008 - \$531), respectively.

**ATLANTIS SYSTEMS CORP.**  
**Notes to the Interim (Unaudited) Consolidated Financial Statements**  
**June 30, 2009 and 2008**  
**(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)**

**11. INTEREST AND FINANCING COSTS, NET**

Interest and financing costs, net for the three months ended June 30, 2009 and 2008 are as follows:

	For the three months ended		For the six months ended	
	June 30		June 30	
	<b>2009</b>	2008	<b>2009</b>	2008
Interest expense <sup>(1)</sup>	\$ 409	\$ 263	\$ 745	\$ 311
Finance and bank charges <sup>(2)</sup>	21	58	64	109
Interest income <sup>(3)</sup>	(6)	(12)	(31)	(33)
	<b>424</b>	309	<b>778</b>	387
Write-off of un-accreted financing costs (note 12)	<b>594</b>	-	<b>594</b>	-
	<b>\$ 1,018</b>	\$ 309	<b>\$ 1,372</b>	\$ 387

<sup>(1)</sup> Includes \$113 and \$238 for the three months and six months ended June 30, 2009, respectively, for the accretion recorded prior to the write-off of the un-accreted financing costs (note 12).

<sup>(2)</sup> Includes \$nil and \$16 for the three months and six months ended June 30, 2009, respectively, for covenant-waiver fees (note 12).

<sup>(3)</sup> Includes \$2 and \$23 in the three months and six months ended June 30, 2009, respectively, for the accrued interest on refundable tax credits.

There were no direct interest and financing costs associated with discontinued operations and interest and financing costs, net, from continuing operations have not been allocated to discontinued operations.

**12. OPERATING LINE OF CREDIT, TERM LOANS AND CASH**

On April 30, 2008, the Company entered into financing arrangements with ComVest that provided up to US\$6,600 of financing in the form of a secured term loan (the "Term Loan") in the amount of US\$2,600 at a rate of interest of 12.5% per annum payable monthly and a deferred interest fee of 5% per annum payable at maturity as well as a secured revolving line of credit (the "Line of Credit") of up to US\$4,000 based on a borrowing base at a rate of interest of US prime plus 2% per annum with a floor of 8% and is collateralized by a general security agreement over all present and future personal property. The Term Loan matures on April 30, 2011 and the Line of Credit will be available until April 30, 2010, subject to a one-year extension at the option of the Company. These financing arrangements closed on May 5, 2008 and the Term Loan was used to repay, in part, the term loan secured from the Company's creditors in the third quarter of 2007. The arrangement also involved the Company issuing warrants to acquire an aggregate of 9,300,000 common shares at an exercise price of \$0.09 per share for a period of five years ("ComVest Warrants").

## **ATLANTIS SYSTEMS CORP.**

### **Notes to the Interim (Unaudited) Consolidated Financial Statements**

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**(Expressed in thousands of Canadian dollars except per share amounts, unless otherwise indicated)**

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The Term Loan requires monthly principal repayments of US\$87 commencing December 1, 2008 and continuing until maturity.

The Company was in breach of the same Term Loan covenant at June 30, 2009, March 31, 2009, and December 31, 2008. In addition, as at June 30, 2009, March 31, 2009, and December 31, 2008, the Company had exceeded its maximum borrowing limit for the revolving Line of Credit by US\$3,594, US\$1,398 and US\$2,469, respectively.

The Company did not request a waiver for the breach of this Term Loan covenant at June 30, 2009 or for the Company exceeding its maximum borrowing limit for the revolving Line of Credit on June 30, 2009 in order to avoid the waiver fee. As a result of these "in default" conditions, the un-accreted balance of \$594 for the finance costs associated with obtaining the ComVest Term Loan were written-off in the second quarter of 2009, and the entire balance of the Term Loan has been classified as a current liability. The Company had previously anticipated that it would violate covenant requirements at future compliance dates and had therefore previously presented the entire balance of the Term Loan as a current liability.

On March 25, 2009, the Board agreed to re-price, subject to regulatory approval, the ComVest Warrants from \$0.09 to \$0.03 per share in lieu of covenant waiver fees that would have been otherwise charged by ComVest for the three month periods ending March 31, 2009, and December 31, 2008 (note 14). The expense of \$16 related to re-pricing the warrants was included in interest expense and financing costs for the first quarter of 2009.

ComVest commenced charging additional default interest of 5% per annum on both the Line of Credit and the Term Loan effective April 1, 2009. The floor interest rate for the Line of Credit and the paid-monthly interest rate for the Term Debt would be 13% per annum and 17.5% per annum, respectively for periods that the Company is in default. The deferred interest rate of 5% per annum for the Term Debt has not changed.

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The Term debt liability includes the following as at June 30, 2009:

Loan proceeds from Comvest	US\$	2,600
Financing costs		(380)
Common share warrants expense		(572)
Accretion		444
Principal payment		(609)
Term debt liability in US currency prior to the write-off of un-accreted financing costs	US\$	1,483
Write-off of un-accreted financing costs		510
Term debt liability in US currency after the write-off of un-accreted financing costs	US\$	1,993
Canadian exchange on loan proceeds		325
Term debt liability in Canadian currency	\$	2,318

The Company has utilized \$5,700 (US\$4,901) of the Line of Credit as of June 30, 2009 (December 31, 2008 – \$3,258 (US\$2,675)).

**13. SHARE CAPITAL**

During the three months ended June 30, 2009, the Company awarded 1,000,000 options to purchase common shares of the Company under our stock option plan (the “Plan”). The options are exercisable at \$0.04 per share for a term of five years and fully vest within 180 days of the date of the grant. No options were awarded in the first quarter of 2009.

The estimated fair value of the options awarded in the three months ended June 30, 2009, 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 assumptions:

Risk-free rate	1.5%
Dividend yield	0%
Volatility factor of expected market price of the Company's shares	171%
Expected option life (in years)	5
Weighted-average grant date fair values of options granted	\$ 0.04

In the three months and six months ended June 30, 2009, no common share stock options were exercised. In the three months and six months ended June 30, 2009 there were 1,357,414 and 1,917,213, respectively, common share stock options that either expired or were cancelled. As at June 30, 2009, the Company had 6,989,694 common share options outstanding.

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In the three months and six months ended June 30, 2009, the Company expensed \$43 (2008 - \$36) and \$96 (2008 - \$72), respectively, relating to the fair value of options granted in fiscal 2008, 2007 and 2006, as is reflected in the Consolidated Statements of Operations, Comprehensive Loss and Deficit.

As at June 30, 2009, the Company had 9,300,000 common share warrants outstanding at an exercise price of \$0.03 per share. The Company's board of directors, subject to regulatory approval, agreed on March 25, 2009 to re-price these warrants from \$0.09 per share to \$0.03 per share (notes 12 and 14). In addition, in the three months and six months ended June 30, 2009, no common share warrants were exercised or expired.

### **14. MANAGING CAPITAL**

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order that it can provide future returns for shareholders and benefits for other stakeholders. Management intends to accomplish this objective with the least dilution to our shareholders. The Company's current situation requires an approach to managing our capital that focuses on generating sufficient cash to fund operations rather than optimizing the cost of capital.

Management believes that the use of debt to equity ratios or similar capital management tools would be inappropriate for the Company's current objectives for managing capital. During 2009 and throughout 2008 the Company did not use capital measurement tools other than those required to monitor and report on its compliance with certain debt covenants. Management is of the opinion that because these capital measurement tools are specific to certain debt instruments, and are not used on a long-term basis by Management to manage capital, disclosure of the details of their definitions and methods of calculation is inappropriate.

For the Term Loan and Line of Credit secured from its bankers in the second quarter of 2008 the Company monitors on a monthly basis its EBITDA to Fixed Charges ratio coverage and its annualized capital expenditures. EBITDA is defined as consolidated net income before interest, taxes, depreciation, amortization and non-cash charges and expenses other than accruals made in the normal course of business less any dividends on capital distribution. Fixed Charges are defined as the sum of the following: all principal payments scheduled or required to be made with respect to the ComVest Tem Loan; all related interest expense; and all income taxes paid or accrued.

The Company was in breach of the Term Loan covenant for minimum EBITDA requirements at June 30, 2009, March 31, 2009, December 31, 2008, September 30, 2008 and June 30, 2008, although the minimum requirements under this covenant were different for each of these reporting periods. In addition, as at June 30, 2009, March 31, 2009, December 31, 2008 and September 30, 2008, the Company had exceeded its maximum borrowing limit for the revolving Line of Credit.

The Company did not request a waiver for the breach of the Term Loan covenant for minimum EBITDA requirements at June 30, 2009 or for the Company exceeding its maximum borrowing limit for the revolving Line of Credit on June 30, 2009 in order to avoid the waiver fee.

On March 25, 2009, the Company's board of directors agreed to re-price, subject to regulatory approval, the ComVest Warrants from \$0.09 to \$0.03 per share. This warrant re-pricing is in lieu of covenant waiver fees that would have been otherwise charged by ComVest for covenant waivers as

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of December 31, 2008 and March 31, 2009. In addition, ComVest had provided waivers without a fee for all breaches prior to December 31, 2008.

The Company includes shareholders' (deficiency) equity and all interest bearing debt in the definition of capital. The components of capital as at June 30, 2009 and December 31, 2008 are as follows:

	<b>June 30, 2009</b>	December 31. 2008
Interest bearing debt	\$ 8,018	\$ 5,455
Shareholders' deficit	<b>(6,223)</b>	(3,290)
<b>Total Capital</b>	<b>\$ 1,795</b>	\$ 2,165

**15. REFUNDABLE DIGITAL MEDIA TAX CREDITS**

On April 15, 2009 the Company received a partial payment of \$1,306, net of applicable fees, from a Government of Ontario refundable tax credit program. On May 17, 2009, the Company received the balance of \$167, net of applicable fees. The Company has recorded a reduction in the cost of revenue of \$167 and \$1,473 for the three months and six months ended June 30, 2009, respectively.

**16. NET LOSS 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 both the three months and six months ended June 30, 2009 was 55,993,929 (2008 - 55,993,929).

The weighted average number of shares outstanding used in the calculation of the diluted earnings per share using the treasury stock method for the three and six months ended June 30, 2009 and 2008 were 55,993,929.

For the three months and six months ended June 30, 2009 and 2008, 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.

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**17. FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

*Financial assets held-for-trading*

Cash is classified as a held-for-trading asset and is recorded at fair value. The fair value of cash is adjusted to its fair market value at the end of each reporting period.

*Financial assets recorded at amortized cost*

Trade receivables and unbilled revenue are classified as loans and receivables and are recorded at amortized cost. The Company has determined that the carrying value represents fair value as at June 30, 2009. The mortgage receivable was recorded at amortized cost prior to June 30, 2009.

*Financial liabilities recorded at amortized cost*

All accounts payable and accrued liabilities, accrued costs on percentage completion, deferred revenue and the term debt are recorded at their amortized cost. The Company has determined that the carrying value represents fair value as at June 30, 2009.

**18. FINANCIAL RISK MANAGEMENT**

*Overview*

The Company has exposure to the following risks from its use of financial instruments:

- (a) Credit risk
- (b) Liquidity risk
- (c) Market risk

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

- (a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The carrying amount of the Company's financial assets represents its maximum credit exposure.

*Cash and cash equivalents*

The Company's cash balance is on deposit in an operating account with a major Canadian bank. As at June 30, 2009, the Company had no cash equivalents. However, in accordance with its investment policy, the Company will only invest in money market deposits with major Canadian Banks and with a maturity of less than 90 days. Accordingly, the Company believes it has minimal credit risk with respect to cash and cash equivalents.

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### *Trade receivables*

In the last three years, the Company's end customers have primarily been the Canadian, US, Australian and Danish military. When the Company does not act as the prime contractor with government agencies, the prime contractor has always been a large, well capitalized aerospace company. The Company also contracts directly with such aerospace companies and has recently contracted with large, well capitalized organizations in the Canadian energy sector. In addition to the intrinsic credit worthiness of this customer base, the Company has contracted with Export Development Canada, when risks warrant, for line of credit guarantees on certain non-domestic projects.

Historically, the Company has not experienced any significant credit losses. The Company does not have any material trade receivable balances greater than 90 days outstanding and has never recorded a material expense associated with a credit risk exposure. As a result, the Company believes that its trade receivables represent a low credit risk. However, due to the nature of the contracts and the complexity of the deliverables to its customers, the Company is exposed to a significantly greater degree of related performance risk.

### (b) Liquidity risk

Liquidity risk arises through an excess of financial obligations over financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available cash to meet its financial obligations as they fall due. In order to meet its financial liabilities, the Company has recently relied on collecting its trade and other receivables and utilizing its operating line of credit. On April 15, 2009 the Company received a partial payment of \$1,306, net of applicable fees, in Government of Ontario refundable tax credit and on May 17, 2009, received the balance of \$167, net of applicable fees.

The Company as of June 30, 2009 exceeded its maximum borrowing limit on the operating line of credit under its financing arrangement with ComVest and is in breach of its EBITDA covenant. Furthermore, the Company did not request a waiver with respect to its non-compliance with the terms of its agreement with ComVest in order to avoid the waiver fee. As a result, the Company's ability to manage its liquidity risk going forward will require some or all of the following: the ability to modify its financing arrangement with ComVest; the ability to secure capital; and the ability to significantly increase its backlog through new contracts being awarded to the Company (note 2). Effective April 1, 2009, ComVest began charging an additional default interest of 5% per annum on the Term Debt and the Line of Credit (note 12).

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The following are the contractual maturities of financial liabilities, including interest payments, as at June 30, 2009.

	Carrying amount	Contractual cash flows	3 months or less	3-12 months	1 - 2 years
<u>ComVest interest rates - not in default</u>					
Accounts payable and accrued liabilities from continuing operations <sup>(1)</sup>	\$ 3,686	\$ (3,686)	\$ (3,333)	\$ (353)	\$ -
Accounts payable and accrued liabilities from discontinued operations	39	(39)	(39)		
Operating line of credit <sup>(2)(3)(5)</sup>	5,700	(6,536)	(114)	(342)	(6,080)
Term debt <sup>(3)(4)(5)</sup>	2,318	(2,857)	(369)	(1,049)	(1,439)
Totals - ComVest interest rates - not in default	\$ 11,743	\$ (13,118)	\$ (3,855)	\$ (1,744)	\$ (7,519)
Incremental term debt maturities due to default condition <sup>(3)(7)</sup>	-	(106)	(26)	(57)	(23)
Totals - ComVest interest rates - in default	\$ 11,743	\$ (13,224)	\$ (3,881)	\$ (1,801)	\$ (7,542)

(1) Does not reflect the recent 50% reduction of bimonthly payouts under settlement agreements with certain former executive officers. This action was taken by the Company, effective March 13, 2009, in order to conserve cash, and is expected to remain in effect until such time as cash flows permit a return to the terms of the settlement agreements. The total obligations under these agreements remain unchanged.

(2) Assumes a non-default scenario with respect to interest rates (floor interest rate of 8% per annum). Also assumes that the operating line balance will not change from the June 30, 2009 levels (no accelerated repayment of amounts currently in excess of the borrowing limit) and that the Company will be able to exercise its option to extend the facility for one year.

(3) Assumes June 30, 2009 US dollar exchange rate for future cash flows.

(4) Assumes a non-default scenario with respect to interest rates (an interest rate of 12.5% per annum, paid monthly, and a deferred interest rate of 5% per annum, payable at maturity).

(5) Assumes there is not an early repayment requirement with respect to the loan covenant or other conditions in breach.

(6) Assumes that the operating line balance will not change from the December 31, 2008 levels (no accelerated repayment of amounts in excess of the borrowing limit), the default interest rate of 13% per annum remains in effect, and that the Company will be able to exercise its option to extend the facility for one year.

(7) Assumes the paid-monthly default interest rate of 17.5% per annum remains in effect throughout the term.

The above tables do not reflect future monthly commitments for lease payments for the Company's rented premises in Brampton, Ontario and Halifax, Nova Scotia. In addition, under the Stand Still Agreement with its landlord, the Company has agreed to pay by December 31, 2009, an amount of \$470 for monthly lease payments in arrears.

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(c) Market risk

Market risk is the risk that changes in the market prices, such as fluctuations in foreign exchange rates and interest rates, will affect the Company's net earnings or the value of its financial instruments.

*Currency risk*

The Company operates internationally giving rise to exposure to changes in foreign exchange rates. The currency risk is derived from revenues denominated in currencies other than the Canadian dollar, its functional currency, primarily the US dollar, and expenses associated with its US operations, as well as the respective receivable and payable balances. The Company believes that it is to a degree naturally hedged with offsetting US dollar expenses related to its US dollar revenue. The Company is also exposed to currency risk on cash, other current assets and the Line of Credit and Term Loan denominated in US dollars.

*Interest rate risk*

The Company is exposed to interest rate risk principally on its operating Line of Credit. Under the agreement with ComVest, interest is payable throughout the term of the facility at US prime plus 2% per annum, with a floor of 8% per annum when not in default, and 13% per annum for periods when the Company is in default (note 12). The US Federal Reserve Board continuously lowered its prime lending rate throughout 2008 in response to the current global financial crisis and at June 30, 2009, the US prime interest rate was 3.25%. As a result, the Company believes it is unlikely during the next 12 months that the interest rate on this facility will exceed either floor rate and therefore expects the interest expense on the operating line to be \$6.7 per month for each \$1,000 of operating line debt, when not in default, and \$10.8 per month for each \$1,000 of operating line debt, when in default. Under the agreement with ComVest, the Term Loan has a fixed monthly interest rate throughout its term of 12.5% per annum, when the Company is not in default, and when in default, an additional 5% per annum. The Company will therefore have for the remainder of the term, average monthly cash interest payments on the Term Debt of approximately \$10.4, when not in default, and \$14.5, when in default. The Company's cash balances are deposited in highly-accessible and low-interest bank accounts and are used for short-term working capital requirements. Accordingly, the Company does not feel that an interest rate sensitivity calculation is material. However, the liquidity risk table in this note includes cash payments for interest on the Line of Credit and the Term Debt for both the in default and not in default scenarios.

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*Quantification of foreign currency risk*

At June 30, 2009, the Company's gross balance sheet exposure to foreign currency risk for continuing operations was substantially as follows:

<i>In Canadian \$ equivalents (000's)</i>	<b>Canadian</b>	<b>US</b>	<b>Total</b>
Cash and cash equivalents	\$ 29	\$ 21	\$ 50
Trade receivables	1,044	568	1,612
Operating line of credit	-	(5,700)	(5,700)
Accounts payable and accrued liabilities	(3,406)	(280)	(3,686)
Term debt	-	(2,318)	(2,318)
Net balance sheet exposure	\$ (2,333)	\$ (7,709)	\$ (10,042)

At June 30, 2009, the Company's gross balance sheet exposure to foreign currency risk for discontinued operations was substantially as follows:

<i>In Canadian \$ equivalents (000's)</i>	<b>Canadian</b>	<b>US</b>	<b>Total</b>
Cash and cash equivalents	\$ -	\$ 3	\$ 3
Trade receivables	-	247	247
Accounts payable and accrued liabilities	-	(39)	(39)
Net balance sheet exposure	\$ -	\$ 211	\$ 211

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The Company's revenue exposure, cost of revenue and operating expense exposure, and interest exposure for revenue and expenses denominated in foreign currencies for the three months and six months ended June 30, 2009 and 2008 for continuing operations were substantially as follows:

Atlantis Systems Corp.

### Consolidated Revenue and Expenses Exposure to Foreign Currency Risk

<i>In Canadian \$ equivalents (000's)</i>	Three months ended June 30, 2009			Six months ended June 30, 2009		
	Canadian	US	Total	Canadian	US	Total
Revenue	\$ 1,360	\$ 632	\$ 1,992	\$ 3,072	\$ 2,382	\$ 5,454
Cost of goods sold and operating expenses	\$ 3,065	\$ 25	\$ 3,090	\$ 5,694	\$ 72	\$ 5,766
Interest and financing costs	\$ (2)	\$ 1,020	\$ 1,018	\$ (24)	\$ 1,396	\$ 1,372

  

<i>In Canadian \$ equivalents (000's)</i>	Three months ended June 30, 2008			Six months ended June 30, 2008		
	Canadian	US	Total	Canadian	US	Total
Revenue	\$ 2,540	\$ 1,295	\$ 3,835	\$ 4,685	\$ 3,130	\$ 7,815
Cost of goods sold and operating expenses	\$ 4,438	\$ 606	\$ 5,044	\$ 8,470	\$ 1,639	\$ 10,109
Interest and financing costs	\$ (5)	\$ 314	\$ 309	\$ (22)	\$ 409	\$ 387

### Fair value sensitivity analysis

*Gross Balance Sheet Exposure:* A 10% strengthening of the Canadian dollar against the US dollar at June 30, 2009 would have decreased the net loss for continuing operations by approximately \$770 for the three month and six month periods ended June 30, 2009, respectively. This analysis assumes that all other variables, in particular interest rates, remain constant and represents the Company's gross balance sheet exposure at June 30, 2009. A 10% weakening of the Canadian dollar against the same would have had an equal but opposite effect.

*Revenue Exposure:* A 10% strengthening on average of the Canadian dollar against the US dollar for the three months and six months ended June 30, 2009 would have decreased net revenue for continuing operations by approximately \$65 and \$240 for the same periods, respectively. This analysis assumes that all other variables, in particular interest rates, remained constant during the quarter, and represents the exposure of the Company's revenues denominated in foreign currencies, to the relative strength of its functional currency. A 10% weakening of the Canadian dollar against the same would have had an equal but opposite effect.

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*Expense Exposure:* A 10% strengthening on average of the Canadian dollar against the US dollar for the three months and six months ended June 30, 2009 would have decreased cost of goods sold, operating expenses and interest expense, in total, for continuing operations, by approximately \$105 and \$145 for the same periods, respectively. This analysis assumes that all other variables remained constant during the quarter, in particularly interest rates, and represents the exposure of the Company's expenses denominated in foreign currencies, to the relative strength of its functional currency. A 10% weakening of the Canadian dollar against the same would have had an equal but opposite effect.

### 19. SEGMENTED INFORMATION

	Three months ended June 30, 2009			Three months ended June 30, 2008		
	Canada	USA	Total	Canada	USA	Total
Revenue from external customers	\$ 1,992	\$ 338	\$ 2,330	\$ 3,835	\$ 410	\$ 4,245
Inter-segment revenues	\$ -	\$ 198	\$ 198	\$ -	\$ 688	\$ 688
Interest revenue	\$ 6	\$ -	\$ 6	\$ 12	\$ -	\$ 12
Interest expense	\$ 409	\$ -	\$ 409	\$ 193	\$ -	\$ 193
Write-off of unaccreted finance costs	\$ 594	\$ -	\$ 594	\$ -	\$ -	\$ -
Amortization of capital assets	\$ 93	\$ 27	\$ 120	\$ 107	\$ 42	\$ 149
Amortization of deferred costs	\$ 266	\$ -	\$ 266	\$ 373	\$ -	\$ 373
Segment loss	\$ (2,642)	\$ (293)	\$ (2,935)	\$ (1,998)	\$ (339)	\$ (2,337)
Segment assets	\$ 7,029	\$ 271	\$ 7,300	\$ 23,207	\$ 592	\$ 23,799
Expenditures for segment capital assets	\$ 10	\$ -	\$ 10	\$ -	\$ 16	\$ 16

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	Six months ended June 30, 2009			Six months ended June 30, 2008		
	Canada	USA	Total	Canada	USA	Total
Revenue from external customers	\$ 5,454	\$ 809	\$ 6,263	\$ 7,815	\$ 769	\$ 8,584
Inter-segment revenues	\$ -	\$ 279	\$ 279	\$ -	\$ 1,280	\$ 1,280
Interest revenue	\$ 31	\$ -	\$ 31	\$ 33	\$ -	\$ 33
Interest expense	\$ 745	\$ -	\$ 745	\$ 241	\$ -	\$ 241
Write-off of unaccreted finance costs	\$ 594	\$ -	\$ 594	\$ -	\$ -	\$ -
Amortization of capital assets	\$ 184	\$ 63	\$ 247	\$ 213	\$ 91	\$ 304
Amortization of deferred costs	\$ 531	\$ -	\$ 531	\$ 748	\$ -	\$ 748
Segment loss	\$ (2,566)	\$ (480)	\$ (3,046)	\$ (3,642)	\$ (997)	\$ (4,639)
Segment assets	\$ 7,029	\$ 271	\$ 7,300	\$ 23,207	\$ 592	\$ 23,799
Expenditures for segment capital assets	\$ 24	\$ -	\$ 24	\$ 19	\$ 17	\$ 36

The allocation of revenue in the above table is based on the location of the operational unit of the Company that performs or subcontracts the work. The U.S. operational unit represents the discontinued operations of the Company.

**Geographic Information**

	Revenue				Capital Assets and Goodwill	
	For three months ended June 30		For six months ended June 30		June 30	
	2009	2008	2009	2008	2009	2008
Canada	\$ 1,360	\$ 2,540	\$ 3,072	\$ 4,685	\$ 2,154	\$ 16,543
International	970	1,705	3,191	3,899	-	236
	\$ 2,330	\$ 4,245	\$ 6,263	\$ 8,584	\$ 2,154	\$ 16,779

The allocation of revenues in the above table to the geographic segments is based upon the location of the customer. Included in international revenue are revenues from discontinued operations of \$338 (2008 – \$410) and \$809 (2008 – \$769) for the three months and six months ended June 30, 2009, respectively.

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**20. NET CHANGE IN NON-CASH WORKING CAPITAL**

Net change in non-cash working capital of continuing operations for the three months ended June 30, 2009 and 2008:

	For three months ended June 30		For six months ended June 30	
	2009	2008	2009	2008
Trade receivables	\$ 1,213	\$ 2,383	\$ (1,109)	\$ 365
Unbilled revenue	255	142	(845)	(317)
Inventory	(155)	17	(128)	(6)
Prepays	74	47	31	213
Accounts payable and accrued liabilities	84	(704)	448	(1,372)
Accrued costs on percentage completion	93	(10)	83	143
Deferred revenue	(44)	(950)	283	19
	<b>\$ 1,520</b>	<b>\$ 925</b>	<b>\$ (1,237)</b>	<b>\$ (955)</b>

**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 for consultants and professional services. In the three months and six months ended June 30, 2009, the Company incurred expenses of \$149 (2008- \$75) and \$326 (2008 - \$278), respectively, for legal services and consulting services with firms in which a director of the Company was an owner, partner or principal. The cost of these services was charged to general and administrative expenses.

Included in accounts payable and accrued liabilities as at June 30, 2009 was \$107 due to the law firm of Gowling Henderson Lafleur LLP of which a former director of the Company was a partner. The director resigned from the Company's board of directors effective March 19, 2009. The amount includes \$61 for services provided prior to the director's resignation. No additional amounts were due to related parties at June 30, 2009.

The Company has entered into a consulting agreement with CEO Capital Corporation in which a director of the Company is a principal shareholder. The consulting agreement commenced in July 2008 for a term of one year and called for a fee of \$25 per month plus expenses. An amount of \$44 for ongoing expenses of CEO Capital was paid and expensed in the second quarter of 2009. In the event CEO Capital earns a fee on a future financing or capital related transaction with respect to the Company, the expense would be deducted from such fees. As at June 30, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in July, 2009.

Effective February 1, 2009, the Company has entered into a one-year investor-relations contract with Breakthrough Growth Corporation in which a director of the Company has a controlling interest. The agreement calls for a fee of \$5 per month plus expenses. As at June 30, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in July, 2009.

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The Company also incurred expenses related to a corporate strategy session of \$6 to an organization in which a director of the Company has a controlling interest, and paid annual fees of \$6 to the Presidents of Enterprising Organizations, an organization of which a director of the Company is a principal, on behalf of the interim CEO of the Company.

In addition, in February, 2009, the Company incurred a onetime charge of \$31 for consulting services from Harborview Advisors LLC in which a director of the Company is a principal.

### **22. SUBSEQUENT EVENTS**

On July 7, 2009, the Company and its landlord executed a Stand Still Agreement (note 8).

Pursuant to notification by the TSX on July 12, 2009, the Company's common shares were to be delisted from the TSX at the close of market on August 11, 2009. The TSX announced on August 11, 2009 that the common shares will now be delisted at the close of market on August 19, 2009 (note 2). The Company has applied to have its common shares listed on the NEX, a separate board of the TSX Venture Exchange. The application is currently under review.

On July 14, 2009, the Company, CEO Capital and ComVest entered into an inter-creditor agreement, whereby the parties agreed to the following: ComVest agreed to share its collateral on the ComVest loans to the Company with bridge loans provided by CEO Capital for up to \$1,500; all parties agreed as to the priority of scheduled repayments; and CEO Capital agreed to provide ComVest with an 120 day cure period in the event of default. On July 14, 2009, CEO Capital provided a \$250 bridge loan to the Company, secured by a promissory note. The promissory note is due on November 11, 2009, unless the due date is extended at CEO Capital's sole option, plus the accrued interest at 2% per month. The interest rate is invariant with respect to default conditions.

In July 2009, the Company reached an agreement with a U.S. based company to transfer our qualification rights to bid as a contractor with the U.S. Army under STOC II. We have received an irrevocable payment of \$130 for completing a written submission to the U.S. Government to transfer these rights ("Novation Request"). An additional \$130 would be due providing that the Novation Request is approved by the U.S. Government (see note 6)

The Company did not request a waiver with respect to its non-compliance with certain terms of an agreement with ComVest for the reporting period ended June 30, 2009 in order to avoid the waiver fee (note 12).