

# VECTOR AEROSPACE CORPORATION

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## *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

This management's discussion and analysis of financial condition and results of operations ("MD&A") has been prepared as of May 11, 2010 and should be read in conjunction with the accompanying interim consolidated financial statements and notes thereto for the three months ended March 31, 2010 and the Company's annual audited financial statements, notes thereto and MD&A for the year ended December 31, 2009 contained in the Company's 2009 annual report. The interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles. All amounts are in Canadian dollars unless otherwise noted.

The consolidated financial statements and MD&A for the year ended December 31, 2009 and the three months ended March 31, 2010 are available on the Company's website at [www.vectoraerospace.com](http://www.vectoraerospace.com) and on SEDAR at [www.sedar.com](http://www.sedar.com).

### **1 SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements in this MD&A are forward-looking statements or information within the meaning of securities laws, collectively "**forward-looking statements**". Forward-looking statements may relate to the future outlook for the Company or anticipated events or results of or involving the Company and may include statements regarding the future financial position, business strategy, projected costs, financial results, taxes and plans and objectives of the Company. Particularly, statements regarding the expectations of strong maintenance, repair and overhaul ("**MRO**") spending continuing, cash flow requirements, and the renewal of original equipment manufacturer ("**OEM**") overhaul service facility agreements are forward-looking statements. In some cases, forward-looking statements can be identified through the use of words or phrases such as "budget," "forecast," "will likely result," "are expected to", "will continue", "is anticipated", "estimated", "intend", "plan", "projection", "could", "may", "believes", "feel", "targeting", "look forward", "goals", "objective", "outlook" and similar expressions or variations of such words and phrases concerning matters that are not historical facts.

Forward-looking statements are based on certain factors and assumptions. Specifically, in the case of the Company's expectations regarding strong MRO spending and its ability to meet cash flow requirements, the Company has assumed that no significant or prolonged disruptions to commercial air travel worldwide occur, that there are no negative changes in government priorities and spending on military aviation activities related to the Company's services, that the Company is able to successfully secure projects in the future, that no significant changes in foreign currency exchange rates occur, and no disruption or shortage of parts from OEMs and others used in providing the Company's services occur. In concluding that the OEM overhaul service facility agreements are likely to be renewed in the ordinary course, the Company has assumed that no changes occur in the customary renewal practices of OEMs and that the Company continues to

experience a positive working relationship with such OEMs. While the Company considers all of these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.

Forward-looking statements are also subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what we currently expect. These factors include global and local political factors, general economic, market and business conditions, fluctuations in the cost of borrowing, the Company's ability to receive timely regulatory approvals, competitive actions of other companies, including increased competition from OEMs with their own in-house service providers, the occurrence of unexpected events such as fires, equipment failures and other similar events affecting the Company or other parties whose operation or assets directly or indirectly affect the Company and future demands for Vector's services, and those risks set forth under the heading "Risk Factors".

The forward-looking statements contained herein are based on the Company's current estimates, expectations, forecasts and projections, which the Company believes are reasonable as of the current date. The reader should not place undue importance on forward-looking statements and should not rely on this information as of any other date. New factors emerge from time to time, and it is not possible for the Company to predict all of such factors and to assess in advance the impact of each such factor on its business or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. Unless otherwise required by applicable law, the Company disclaims any intentions or obligation to update or revise any forward-looking statements or comments as a result of any new information, future event or otherwise.

## 2 OVERALL PERFORMANCE

### 2.1 Business of the Company

Vector Aerospace Corporation ("**Vector**" or with its various subsidiaries "**the Company**") is a global provider of aviation maintenance, repair and overhaul ("**MRO**") services for fixed and rotary wing aircraft gas turbine engines, helicopter dynamic components and helicopter airframes. The Company has full service overhaul facilities in Canada, South Africa and the United Kingdom and smaller regional service facilities in the United States and Kenya serving both commercial and military markets.

Vector holds approvals from many of the world's leading original equipment manufacturers ("**OEMs**") including: AgustaWestland, Bell Helicopters, Boeing, Eurocopter, General Electric, Pratt & Whitney Canada, Rockwell Collins, Rolls Royce, Sagem Avionics, Sikorsky and Turbomeca. These approvals allow Vector to provide a breadth of capabilities and service offerings which will allow the Company to continue to grow profitably.

Vector was founded in 1998 and acquired the fixed-wing aircraft engine repair and overhaul business from Atlantic Turbines International Inc., the fixed-wing aircraft and industrial turbine engine repair and overhaul business from Canadian Helicopters (Barbados) Limited, and the rotary-wing aircraft repair and overhaul business from Canadian Helicopters Limited. In 1999,

Vector expanded its rotary-wing aircraft repair and overhaul business by acquiring the shares and net assets of the various entities in the Helipro Group of Companies ("**Helipro**") as well as the net assets and businesses of various entities that comprised Alameda Aerospace ("**Alameda**"). In 2008, Vector through one of its subsidiaries, acquired the businesses, assets and working capital of the Defence Aviation Repair Agency ("**DARA**") Rotary Wing and Components operations from the United Kingdom Ministry of Defence ("**MoD**").

In 2008, the Company undertook a transition to a 'One Vector' approach and is now utilizing its corporate brand at all of its operating units. This exercise has resulted in the legal name changes of the operating divisions. In March 2008, ACROHELIPRO Global Services Inc. changed its legal name to Vector Aerospace Helicopter Services Inc. ("**Helicopter Services-NA**" or "**HS-NA**"). In April 2008, certain DARA businesses were purchased by Vector Aerospace International Limited ("**Helicopter Services-UK**" or "**HS-UK**"). In July 2008, Sigma Aerospace Limited changed its legal name to Vector Aerospace Engine Services UK Limited ("**Engine Services-UK**" or "**ES-UK**"). In November 2008, Atlantic Turbines International Inc. changed its legal name to Vector Aerospace Engine Services-Atlantic Inc ("**Engine Services-Atlantic**" or "**ES-Atlantic**").

## **2.2 2009 Business Acquisition – Vector Africa**

On December 18, 2009, the Company purchased 100% of the common shares and business operations of Pratt & Whitney Canada CSC Africa (Proprietary) Limited for consideration of \$11,063,000 subject to a working capital adjustment. The estimated working capital adjustment is expected to reduce the purchase consideration. The working capital adjustment and balance of the consideration due to the vendor after closing is expected to be settled during 2010. The acquisition was financed through existing credit facilities. The results of the renamed entity, Vector Aerospace Africa (Proprietary) Limited ("**Vector Africa**"), have been included in the Company's financial statements since December 1, 2009, the effective date of the acquisition. ES-Atlantic manages Vector Africa.

Vector Africa is located at Lanseria Airport near Johannesburg, South Africa and provides maintenance, repair and overhaul services.

The acquisition has been accounted for using the purchase method of accounting and the purchase price has been allocated based on the fair values of the assets acquired and liabilities assumed.

The net assets acquired are as follows:

	Purchase Price
<b>Assets Acquired:</b>	
Cash and cash equivalents	\$ 1,024
Other assets – Current	4,249
Fixed assets	3,067
Intangible assets	2,531
	\$ 10,871
<b>Liabilities assumed:</b>	
Payables and accruals	\$ 784
	\$ 784
<b>Net assets acquired</b>	<b>\$ 10,087</b>
<b>Purchase consideration:</b>	
Cash paid on closing	\$ 7,184
Estimated working capital adjustment and amount due to vendor post closing	2,474
Acquisition costs	429
<b>Total purchase consideration</b>	<b>\$ 10,087</b>

The fair value of the net assets acquired of \$11,357,000 exceeded the total purchase consideration by \$1,270,000. The excess was allocated proportionally as a reduction to the values of fixed assets and intangibles.

## 2.3 Business Segments

Effective April 1, 2009, the Company has changed the reporting of its operating segments to better reflect the current organizational structure. All prior period comparatives have been restated to reflect the new segments. The Company evaluates business segment performance based on earnings from operations before any unusual items.

The Company provides MRO services through three business segments — Engines, Airframes and Components.

The **Engines** segment provides MRO services on turboprop, turboshaft and turbofan gas turbine engines for military and commercial customers. This segment includes ES-Atlantic, ES-UK, and some operations of HS-NA. ES-Atlantic has overhaul facilities operating in Summerside, Prince Edward Island and Johannesburg, South Africa and smaller regional service facilities in the United States, South Africa and Kenya. HS-NA provides MRO services on a range of turboshaft engines with overhaul facilities in Richmond, British Columbia and smaller regional service facilities in the United States. ES-UK has overhaul facilities in Croydon and Gosport, United Kingdom.

The **Airframes** segment provides MRO services on helicopter airframes for both military and commercial customers. This segment includes HS-UK with helicopter airframe repair facilities in

Gosport, United Kingdom, and HS-NA offering airframe MRO capabilities and supplemental type certificate development activities with comprehensive overhaul/maintenance facilities in Langley, British Columbia and Andalusia, Alabama.

The **Components** segment that services components such as gearboxes and main rotorheads includes HS-UK through component overhaul facilities in Perth, Scotland and HS-NA with helicopter component overhaul facilities in Richmond, British Columbia and Andalusia, Alabama.

## 2.2 Revenue Categories

### 2.2.1 Revenue by category of customer

(Millions of Canadian Dollars)	Three Months Ended March 31			
	2010		2009	
<b>Military</b>				
Engines	\$21.3	16.6%	17.9	12.7%
Airframes	31.6	24.7%	30.1	21.4%
Components	15.6	12.2%	17.8	12.7%
	<b>\$68.5</b>	<b>53.5%</b>	\$65.8	46.8%
<b>Commercial &amp; Other</b>				
Engines	53.1	41.4%	66.3	47.1%
Airframes	3.6	2.8%	4.0	2.8%
Components	2.9	2.3%	4.6	3.3%
	<b>\$59.6</b>	<b>46.5%</b>	74.9	53.2%
<b>Total Revenue</b>	<b>\$128.1</b>	<b>100.0%</b>	\$140.7	100.0%

**Military Engine** revenue is generated by both HS-NA and ES-UK. HS-NA provides MRO services to a number of military and para-public customers. HS-NA performs MRO work for the Canadian Department of National Defense ("**Canadian DND**") on the Sea King (CH-124), Griffon (CH-146), Buffalo (CC-115) and Cormorant (CH-149) aircraft. The engine overhaul and repair work for L-3 Communications is completed at HS-NA's facility in Richmond, British Columbia. In addition, HS-NA provides repair and overhaul services for various United States military organizations on the Rolls Royce 250 engines ("RR250") and Sikorsky H3 (US military variant of Sea King) helicopters. Military revenues also include services provided to a number of para-public organizations including police forces, national guards and border patrol units. ES-UK revenue is primarily from the Rolls-Royce T56 engine, which powers the C-130 Hercules aircraft for customers such as the UK Ministry of Defense ("MoD"), the Royal Saudi Air Force ("**RSAF**") and the Belgian Air Force. ES-UK also performs work for the MoD on the Conway engine, which powers its fleet of VC10 mid-air refueling jets.

Military Engine revenues have increased in the first quarter for 2010, as compared to the same period of 2009, primarily as a result of higher North American inputs partially offset by weaker United Kingdom activity on the RSAF contract for the T56 engine and the weaker Pound Sterling.

**Military Airframe** revenue is generated by both HS-UK and HS-NA. HS-UK derives its military airframe revenue from aircraft that are utilized by the UK MoD. In North America, HS-NA performs structural repair and overhaul work at the Richmond, British Columbia facility for Canadian DND and Andalusia, Alabama for L-3 Communications on US Navy aircraft from Whiting Field.

Overall, Military Airframe revenue increased in the first quarter of 2010, as compared to 2009 primarily driven by strong activity levels in the United Kingdom partially offset by the weaker Pound sterling.

**Military Component** revenue is generated by both HS-UK and HS-NA. HS-UK component overhaul facilities service the UK MoD and HS-NA performs component repair and overhaul work for Canadian DND and for L-3 Communications on US Navy aircraft.

Military Component revenue for the first quarter of 2010 decreased as compared to the same period of 2009 due to decreased activity in the United Kingdom and the weaker Pound Sterling.

**Commercial/Corporate Engine** revenue is generated by both ES-Atlantic and HS-NA. ES-Atlantic customers primarily operate PW100 on turboprop powered aircraft such as the Dash 8, Embraer 120, and ATR 42/72. Other Commercial Engine customers utilize PT6A powered turboprop aircraft such as the King Air and Cessna Caravan. The JT15D engine powers certain business jet aircraft, such as the Cessna Citation and Hawker Beechcraft Beechjet 400. MRO activity for business customers is generally less frequent than commercial customers such as regional airlines, since flying hours are fewer. The Company services a small share of the corporate market for the PT6A and JT15D and believes it can increase its market share as a result of faster turn times and higher levels of customer service. HS-NA customers operate in a variety of commercial sectors, including offshore oil and gas, mining, forestry, EMS and tourism.

During the first quarter of 2010, Commercial Engine revenue decreased over the same period of 2009 primarily due to decreased PW100, PT6A, Arriel and T700 activity levels and a weaker US dollar offset partially by an increase in JT15D inputs. PW100 revenues for the quarter as compared to last year were negatively impacted by maintenance schedule timing for regional aircraft customers.

**Commercial Airframe** revenue is generated by HS-NA whose customers operate in a variety of commercial sectors, including offshore oil and gas, mining, forestry, EMS and tourism.

Commercial Airframe revenue in the first quarter of 2010 decreased when compared to the same period of 2009. Increased project completions in North America were more than offset by the impact of the weaker US dollar.

**Commercial Component** revenue is generated by HS-NA whose customers operate in a variety of commercial sectors, including offshore oil and gas, mining, forestry, EMS and tourism.

Commercial Component revenue in the first quarter 2010 was lower than the same period in 2009 due to lower activity in North America.

## 2.2.2 Revenue by geographic location of customers

	Three Months Ended March 31			
	2010		2009	
United Kingdom	\$ 41.8	32.6%	\$ 44.0	31.2%
United States	31.0	24.2%	36.8	26.2%
Canada	28.5	22.2%	22.0	15.6%
Central & South America	7.5	5.9%	3.6	2.6%
Africa	6.9	5.4%	8.4	6.0%
Other European Countries	5.5	4.3%	15.6	11.1%
Asia	3.9	3.0%	4.0	2.8%
Middle East	0.1	0.1%	3.0	2.1%
Other Countries	2.9	2.3%	3.3	2.4%
<b>Total Revenue</b>	<b>\$ 128.1</b>	<b>100.0%</b>	<b>\$ 140.7</b>	<b>100.0%</b>

Customers operating in the United Kingdom, United States, and Canada represent more than 75% of revenue for the Company. Revenue for the first quarter of 2010 from customers in the United Kingdom, as compared to the first quarter of 2009, decreased as a result of the weaker Pound Sterling in comparison to the Canadian dollar. Revenue from customers operating in United States decreased in the first quarter of 2010, as compared to the same period in 2009, primarily as a result of the weaker US dollar in comparison to the Canadian dollar. Revenue from customers operating in Canada increased for the first quarter of 2010, when compared to the first quarter of 2009, primarily due to higher activity of the Canadian military and ES-Atlantic customers. Revenue from customers operating in the Middle East decreased for the first quarter of 2010, as compared to the first quarter of 2009, as a result of lower activity levels on the RSAF contract which was completed in 2009.

For the first quarter of 2010, two customers individually accounted for more than 10% of the Company's revenue (\$13.7 million or 10.7% and \$13.3 million or 10.4%). For the first quarter of 2009, one customer accounted for more than 10% of the Company's revenue (\$15.6 million or 11.1%).

The Company believes that it has a diversified range of products and service offerings across the major segments of the market. The Company believes that military customers operating in different geographic areas are a stabilizing factor for the Company.

## 2.3 Business Strategy

Vector's strategic vision is to "Set the Standard of Customer Service" for the industry. The Company aims to be the benchmark against which all MRO businesses are measured. Vector expects to achieve this by partnering with OEMs as an integrated solution provider and by adding value for its customers and OEMs.

Vector continually looks for opportunities to profitably expand its business and increase shareholder value. The Company does this by ensuring the stability of its balance sheet and existing business, and by adding new capabilities to achieve long term growth.

The Company has strong relationships with most major engine and helicopter airframe OEMs and offers a wide range of services to both commercial and military customers.

## 2.4 General

The Company's guiding principle is to partner with its OEMs as an integrated solutions provider. The Company will continue to focus on:

- Meeting its commitments to its customers, OEMs, employees and shareholders
- Streamlining existing processes to improve efficiencies and reduce costs
- Modifying its product offerings so that it can find innovative opportunities to create additional value
- Maintaining and leveraging relationships with existing customers and OEMs
- Expanding its market share profitability from a broad base of military, government, commercial and corporate customers around the world
- Improving liquidity in its Balance Sheet so that it can take advantage of unique opportunities should they arise

### 2.4.1 Strategic Focus – Engines

The Company's strategic focus for its engines business segment will be to position itself as the market leader for the products it services in the turboprop, turboshaft and turbofan engine markets. This strategy will include the expansion of its market share in current and new geographical segments on existing product lines as well as the addition of new engine programs through OEM partnerships or acquisitions. The Company believes it can gain market share in its offerings by enhancing the standards of customer service through augmenting reliability and reducing turn time.

The Company believes that a balance of military and non-military customers in its engines business segment benefits the stability of earnings and enhances growth prospects.

Vector's short term focus related to its military engines business will be centered around increasing its customer base for the T56 engine line while still maintaining its MRO revenue on the Conway engine used by the MoD in its mid air refueler. The MoD's current mid air refueler is due for replacement over the next five years. The Company is developing and expects to continue to develop other revenue sources to replace this business as part of its ongoing strategic planning. Vector will also look to expand its market share for the T700 engine for both foreign and domestic military applications.

The Company's commercial engines business will focus on the continued expansion of its service network into new geographies which have been identified as key developmental opportunities in the short to medium term. Long term strategy for the commercial business will also include the addition of new platforms to the portfolio.

The DARA acquisition provided the Company with a base to expand its European presence and product offering. In 2008, the Company secured a new OEM overhaul and service facility agreement for certain variants of the Pratt & Whitney Canada 307/308 engine which is primarily used on corporate aircraft. The facility authorized to carry out the MRO work on this engine is Vector's engine shop in Gosport, England, which was acquired as part of the DARA assets.

#### **2.4.2 Strategic Focus – Airframes & Components**

Vector is well positioned for growth as a helicopter airframe and components MRO provider. The strategic focus of the airframes and components segment will be to leverage the current OEM relationships and to expand into new geographic markets. As with the engines segment, Vector will focus on delivering enhanced customer service by improving reliability and reducing turn time.

The DARA acquisition expanded Vector's OEM relationships to include Boeing and AgustaWestland. In the medium term, the focus will be to expand its presence in the UK by adding new capabilities while growing its current base business. In the medium to longer term, Vector aims to use its UK facilities to expand its presence into Europe in both the military and commercial helicopter and component markets.

The Company believes that military helicopter airframe and components MRO spending by governments in North America and the UK will continue at strong levels for the near term as a result of the ageing fleet and helicopter life extension upgrade programs, and the number of military conflicts around the world. The Company is and will continue to pursue new military contracts based on its existing capabilities and anticipates continued growth in military MRO revenues.

The Company believes that military customers operating in different geographic areas will continue to be a stabilizing factor for the Company.

Vector is also uniquely positioned through its global facilities and current offerings to access the growing modifications and legacy platform enhancement programs. The Company believes its investments in proprietary Supplemental Type Certificates (STCs) will provide a strong revenue stream in the short to medium term in its commercial airframes and components segment.

#### **2.4.3 Competitive Environment**

Vector is recognized and respected as one of the largest independent MRO service providers for the products it supports. The Company competes with several independents offering a range of MRO capabilities, OEMs who have their own in-house MRO divisions and aircraft operators who run their own MRO operations. For the military market, local governments and OEM's provide the majority of MRO services, however, there is an ongoing trend by many governments to outsource these activities to reduce costs. The Company operates on a variety of military and commercial platforms, and continues to look to expand its markets and service offerings. The Company defines its market as the 'Addressed Market', which represents the total available market for the products which the Company currently services.

Within the Company's current addressed market of fixed-wing and helicopter engine MRO services, annual expenditures are currently estimated to be \$3.6 billion per year. OEMs control approximately 30% of this market while independents, such as Vector, account for over 50%. The remaining 20% is spread across militaries and aircraft operators. The engine market continues to be a strong growth sector for Vector where base volume and scale as well as OEM relationships are critical success factors for growth.

Within the Company's current addressed market for civil and military helicopter airframe and components MRO services, annual expenditures is currently estimated to be \$2.3 billion. OEMs, militaries and commercial operators account for approximately 35% of this market. Competitive labour rates, location, on time delivery to customers and military airframe expertise are critical success factors in the helicopter market.

The demand for MRO services is driven by the size and age of the aircraft fleet, aircraft utilization and changes in safety and public regulation. Successful MRO companies provide high quality service, with quick response times at competitive prices for the range of product lines and services they offer. The Company has developed a solid reputation of customer service and management believes that it compares favourably to its competitors.

### 3 RESULTS OF OPERATIONS

#### 3.1 Overall Performance

Revenue and earnings from operations for the first quarter 2010 as compared to the first quarter of 2009 were broadly impacted by:

- The weaker US dollar and United Kingdom Pound Sterling as compared to the Canadian dollar for 2010 as compared to 2009 (see section 6.2 for further discussion);
- The global economic downturn. Activity levels related to military aircraft have not been significantly impacted by the economic downturn and continue to exhibit signs of continued strength. Commercial, corporate and utility use aircraft MRO activities have been negatively affected, which the Company has been able to partially offset by increasing its global market share

#### 3.2 Revenue

Outlined below is the Company's comparative revenue:

(Millions of Canadian Dollars)	Three Months Ended March 31			
	2010		2009	
Engines	\$ 74.4	58.1%	\$ 84.2	59.8%
Airframes	35.2	27.5%	34.1	24.3%
Components	18.5	14.4%	22.4	15.9%
Total Revenue	\$ 128.1	100.0%	\$ 140.7	100.0%

The Company derives the majority of its revenue from servicing a variety of turbofan, turboprop and turboshaft gas turbine engines.

Revenues in the engine category for the first quarter of 2010 decreased over the same period of 2009 primarily as a result of the impact of changes in foreign exchange rates. Activity levels decreased from North American commercial customers and a military engine customer (RSAF) in the United Kingdom.

Airframe revenues increased in the first quarter of 2010 as compared to 2009 as a result of strong United Kingdom project completions.

Component revenues decreased in the first quarter of 2010 in comparison to the same period of 2009 due to lower activity in both North America and the United Kingdom.

### 3.3 Operating Results

Outlined below are the Company's comparative segment earnings:

<i>(Millions of Canadian Dollars)</i>	<b>Three Months Ended</b>		
	<b>2010</b>	2009	Change
			<b>March 31</b>
<b>Segments</b>			
Engines	<b>\$6.7</b>	\$ 8.6	\$(1.9)
<i>% of segmented revenue</i>	<b>9.0%</b>	10.2%	
Airframes	<b>7.5</b>	5.3	2.2
<i>% of segmented revenue</i>	<b>21.3%</b>	15.4%	
Components	<b>1.1</b>	2.1	(1.0)
<i>% of segmented revenue</i>	<b>6.1%</b>	9.5%	
Corporate and other	<b>(3.0)</b>	(2.7)	(0.3)
<i>% of total revenue</i>	<b>(2.4%)</b>	(1.9%)	
<b>Earnings from</b>			
Operations	<b>\$12.3</b>	\$13.3	(1.0)
<i>% of total revenue</i>	<b>9.6%</b>	9.5%	

Earnings from operations are defined as earnings before unusual items, interest and taxes.

Details by business segment are as follows:

#### 3.3.1 Engines

Segment earnings for the first quarter of 2010 relating to engine operations decreased over the same period of the prior year primarily as a result of lower earnings at ES-Atlantic. Such reductions were driven by lower revenues and margins resulting from changes in product mix and the foreign exchange rates.

### **3.3.2 Airframes**

Segment earnings related to airframe operations for the first quarter of 2010 increased over the same quarter in 2009 as a result increased revenues and margins in the United Kingdom due to productivity improvements and changes in product mix.

### **3.3.3 Components**

Segment earnings related to component operations for the first quarter of 2010 were lower than the same quarter in 2009 as a result of lower activities.

### **3.3.4 Corporate and other expenses**

For the quarter ended March 31, 2010, corporate and other expenses increased over the same period for the prior year, primarily due to the negative impact of foreign exchange losses of \$1.1 million as compared to a foreign exchange loss of \$0.5 million in 2009.

### **3.4 Unusual Item**

During the first quarter of 2010, the company recorded a charge of \$0.2 million related to costs pertaining to the restructuring and relocation of its T56 engine MRO operations in the UK to enhance synergies and streamline processes.

### **3.5 Amortization and Depreciation**

Amortization and depreciation expense was \$3.0 million for the first quarter of 2010 as compared to \$1.9 million in the same period in 2009, primarily as a result of the commencement of amortization of the 307/308 engine shop and OEM overhaul and service agreement and new equipment depreciation at HS-NA and HS-UK.

### **3.6 Interest Expense**

Interest expense was \$0.6 million for the first quarter of 2010 as compared to \$1.6 million for the same period of 2009. Interest expense has been affected by debt reductions from scheduled principal repayments and additional repayments in late 2009. Such additional repayments came from the funds raised in the 2009 public share offering (See section 5.6).

### **3.7 Income Tax Expense**

The effective tax rate for the first quarter of 2010 was approximately 26%, compared to 22% in for the first quarter of 2009 as a result of changes in the mix of profits earned from the various jurisdictions in which the company operates.

Tax provisions are affected by different tax rates and laws in the various jurisdictions in which the Company operates. The effective tax rate is therefore impacted by the income earned in each jurisdiction and periodic adjustments to the valuation allowance associated with the tax losses carried forward.

Income tax expense is also affected by the utilization of income tax losses carried forward, for which the benefit had not been previously recorded on the balance sheet, which results in a reduction to tax expense. Also, the Company receives a rebate of the provincial tax for earnings generated in Prince Edward Island which also reduces tax expense. The Company's future

effective tax rate is expected to fluctuate, as a result of changes in where the Company's profits are earned and the diminished impact of the utilization of income tax losses carried forward for which the benefit has not been previously recorded on the balance sheet. During 2010, there was minimal utilization of income tax losses carried forward for which the benefit had not been previously recorded.

### **3.8 Net Earnings**

Net earnings in the first quarter of 2010 were \$8.5 million compared to \$9.2 million in the same period in the prior year. First quarter basic earnings per share were \$0.19 (2009 - \$0.24) and diluted earnings per share were \$0.18 (2009 - \$0.24). Year over year earnings per share were impacted by the share offering completed in the fourth quarter of 2009 (See section 5.6).

### **3.9 Comprehensive Income**

Comprehensive income represents the change in shareholders equity, which results from transactions and events from sources other than the Company's shareholders. These transactions and events include unrealized gains and losses resulting from changes in the market value of interest rate swaps net of taxes.

Vector's foreign subsidiaries are operationally self-sustaining. Accordingly, their assets and liabilities are translated into Canadian dollars at period end exchange rates. Unrealized gains and losses resulting from translation of self-sustaining foreign operations are recorded as part of Comprehensive Income in Shareholders' Equity. The foreign currency translation adjustment ("CTA") represents the unrealized gain or loss on Vector's net investment in self-sustaining foreign operations. The CTA increased by \$5.4 million in the first quarter of 2010 (2009 - decrease of \$1.5 million) as a result of the US dollar and British Pound Sterling fluctuations in relation to the Canadian dollar during those periods.

The impact of marking the value of interest rate swaps to market for the first quarter 2009, net of tax, was a gain of \$0.2 million. The interest rate swap arrangements expired on November 30, 2009.

## 4 SELECTED QUARTERLY FINANCIAL INFORMATION

Comparative selected quarterly financial information is as follows:

(in \$ millions except share amounts)

	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008
<b>Revenues</b>								
Engines	\$74.4	\$85.0	\$84.5	\$87.2	\$84.2	\$82.5	\$84.5	\$87.2
Airframes	35.2	33.0	36.5	39.0	34.1	33.1	27.5	30.8
Components	18.5	19.7	20.0	20.8	22.4	25.8	23.1	20.2
<b>Total</b>	<b>\$128.1</b>	<b>\$137.7</b>	<b>\$141.0</b>	<b>\$147.0</b>	<b>\$140.7</b>	<b>\$141.4</b>	<b>\$135.1</b>	<b>\$138.2</b>
<b>Earnings from operations before the undernoted</b>								
Engines	\$6.7	\$6.7	\$9.6	\$9.1	\$8.6	\$8.4	\$8.3	\$11.4
Airframes	7.5	4.5	5.4	6.3	5.3	2.3	1.3	2.0
Components	1.1	2.0	1.6	1.8	2.1	2.6	0.8	0.6
Corporate and other	(2.0)	(2.9)	(2.4)	(2.9)	(2.2)	(2.4)	(2.6)	(1.8)
Foreign Exchange	(1.0)	(0.3)	(1.8)	(2.0)	(0.5)	(0.3)	0.8	0.5
<b>Total</b>	<b>\$12.3</b>	<b>\$10.0</b>	<b>\$12.4</b>	<b>\$12.3</b>	<b>\$13.3</b>	<b>\$10.6</b>	<b>\$8.6</b>	<b>\$12.7</b>
<b>Unusual items</b>	<b>(0.2)</b>	<b>(1.3)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(0.9)</b>
<b>Earnings from operations</b>	<b>\$12.1</b>	<b>\$8.7</b>	<b>\$12.4</b>	<b>\$12.3</b>	<b>\$13.3</b>	<b>\$10.6</b>	<b>\$8.6</b>	<b>\$11.8</b>
<b>Net earnings</b>	<b>\$8.5</b>	<b>\$6.2</b>	<b>\$7.8</b>	<b>\$7.9</b>	<b>\$9.2</b>	<b>\$5.7</b>	<b>\$6.6</b>	<b>\$8.3</b>
<b>Net earnings per share (basic)</b>								
Basic	\$0.19	0.14	0.21	0.21	0.24	0.15	0.17	0.22
Diluted	\$0.18	0.14	0.21	0.21	0.24	0.15	0.17	0.22
<b>Weighted average number of common shares outstanding (in millions)</b>								
Basic	46,000	43,924	37,756	37,733	37,718	37,703	37,694	37,661
Diluted	46,483	44,430	38,352	38,001	37,927	37,917	38,022	37,972

The 1<sup>st</sup> quarter (Q1) is for the period from January 1 to March 31, the second quarter (Q2) is for the period from April 1 to June 30, the third quarter (Q3) is for the period from July 1 to September 30 and the fourth quarter (Q4) is for the period from October 1 to December 31.

Earnings from operations is defined as earnings before interest and taxes.

## **5 LIQUIDITY AND CAPITAL RESOURCES**

### **5.1 Operating Activities**

Cash flow generated from operations before changes in non-cash working capital for the first quarter of 2010 increased by \$13.1 million compared to an increase of \$10.8 million for the first quarter of 2009 due to increased earnings prior to amortization and changes in the defined benefit plan.

During the first quarter of 2010, the Company used \$18.7 million of cash from changes in non-cash working capital as compared to \$11.1 million for the same quarter in 2009. Cash used in the first quarter of 2010 from changes in non cash working capital related primarily to higher levels of work in progress and lower levels of payables and accruals, and deferred revenues.

### **5.2 Investing Activities**

Investing activities in the first quarter of 2010 include cash payments for tooling and equipment, rental engines and the renewal of OEM overhaul and service facility agreements. In the first quarter of 2009, investing activities included additions to fixed assets and the post-closing working capital adjustment related to the DARA facilities acquisition in the United Kingdom.

### **5.3 Financing Activities**

Financing activities in the first quarter of 2010 included the issuance of \$5.2 million of long term debt. Payments on long-term debt were \$3.2 million in the first quarter of 2009 and 2010.

### **5.4 Credit Facilities**

The Company has separate credit facilities and associated financial covenants in place for its North American operations and for its HS-UK and ES-UK operations. At March 31, 2010, all of the Company's operating and term facilities in North America and United Kingdom were within the terms established in the associated loan agreements.

At March 31, 2010 the Company had operating credit facilities totaling \$52.0 million (December 31, 2009 – \$53.6 million) and long-term debt of \$63.7 million (December 31, 2009 – \$63.1 million). The Company's operating credit facilities in North America and the UK are each subject to a borrowing base calculation that restricts borrowing amounts based on percentages of inventory and certain accounts receivable. Each of the North American and UK operating credit facilities borrowing base varies on a monthly basis. There were no borrowings under the operating facility at March 31, 2010 (December 31, 2009 – \$0.5 million). In addition, the Company had outstanding letters of credit of \$3.0million at March 31, 2010 (December 31, 2009 – \$3.2 million). At March 31, 2009, the Company had unused, available operating credit facilities of approximately \$35.0 million (December 31, 2009 – \$35.0 million) in North America and \$14.0 million, equivalent to £9.1 million (December 31, 2009 – \$15.0 million, equivalent to £8.8 million) in the UK after taking into account the borrowing base calculation.

## **5.5 Debt Agreements**

The terms of some of the Company's debt agreements impose certain operating and financial limitations on the Company. Such agreements limit, among other things, the Company's ability to increase indebtedness, create liens, make capital expenditures subject to certain limitations, engage in mergers or acquisitions, sell assets, transfer funds between companies within the Vector group and make dividend payments. These limitations have not hampered the Company's ability to conduct normal operations.

The Company's ability to comply with any of the foregoing operating and financial limitations, and with its loan repayment provisions, will depend upon its future performance. This will be subject to prevailing economic conditions and other factors, some of which may be beyond the Company's control.

The Company believes that cash flow from operations and unused operating facilities will be sufficient to fund its working capital, debt service and capital expenditure requirements for the near future.

## **5.6 Public Share Offering during 2009**

On October 20, 2009, the Company completed an issuance to the public of 7,100,000 common shares at a price of \$6.35 per common share, pursuant to a final short form prospectus dated October 9, 2009. On November 17, 2009, the Company completed an issuance to the public of an additional 1,065,000 common shares at a price of \$6.35 per common share. The net proceeds of the offering after deducting the underwriters' and share capital fees were \$48.7 million. The proceeds were used to pay down part of the existing debt and the remainder for general corporate purposes.

# **6 RISKS AND UNCERTAINTIES**

## **6.1 Sensitivity Analysis**

The Company records transactions and prepares its financial statements in Canadian dollars. For the period ended March 31, 2010, the Company had significant operating facilities in Canada, the United States, and the United Kingdom.

Non-Canadian operations are considered financially and operationally self-sustaining. Accordingly, all of the Company's assets and liabilities are translated into Canadian dollars at the closing exchange rates as of the date of the Balance Sheet. Revenue and expense items for self-sustaining foreign operations are translated into Canadian dollars monthly at the opening exchange rate for that month.

The majority of the Company's North America operations invoice their non-military customers in US dollars. Military customers are invoiced in the native currency of the customer. Virtually all of the Company's inventory and purchased parts are invoiced to the Company in US currency. Foreign currency revenues earned and expense incurred within an operating facility are translated monthly to the native currency of the operating unit, based on the opening exchange rate for that

month. Accounts receivable, inventory and monetary assets and liabilities, including debt, are translated to Canadian dollars at the exchange rate as at the Balance Sheet date.

The Company performs sensitivity analysis to assess the impact on net earnings due to the impact of hypothetical changes in foreign currency exchange rates and interest rates. Information provided by the analysis does not necessarily represent the actual changes in value that the Company would incur under normal market conditions. For the purposes of this sensitivity analysis noted below all variables, other than the specific market risk factor, are being held constant.

## 6.2 Foreign Currency Exchange Rate Risk

In the first quarter of 2010, 52% (2009 – 60%) of the Company's revenue and 45% (2009 – 49%) of expenditures were denominated in US dollars. As well, 39% (2009 – 33%) of the Company's first quarter revenue and 36% (2009 – 33%) of first quarter expenditures were denominated in Pound Sterling. The US dollar exchange rate (\$1US equivalent in Canadian funds) averaged \$1.06 during the first quarter of 2010 compared with \$1.24 during the same period in the prior year. The Pound Sterling exchange rate (£1 equivalent in Canadian funds) averaged \$1.62 during the first quarter of 2010 compared with \$1.80 during the same period in the prior year. Using the prior year's exchange rates for both the US dollar and the Pound Sterling, revenues in the first quarter of 2010 would have been \$18.4 million higher.

Significant portions of the Company's expenditures are also denominated in these currencies and therefore, a natural hedge exists for much of this exposure. However, a net exposure exists for US dollar and British Pound Sterling cash flows that can affect earnings as the Canadian dollar exchange rate changes in relation to these currencies. It is estimated that a one cent change in the Canadian dollar equivalent value of £1 and US\$1 respectively, with all other variables being held constant, would affect earnings from operations by approximately \$55,000 and \$156,000 for the first quarter of 2010. Information provided by this analysis does not necessarily represent the actual changes that the Company would or has incurred as a result of changes in exchange rates. Ongoing continuous improvement programs are in place, however, there is no certainty that such programs will offset the impact of fluctuating exchange rates in the future.

Shareholders' equity includes a currency translation adjustment related to the Company's net investment in self-sustaining subsidiaries. A one-cent change in the value of the Canadian dollar in relation to the US dollar and Pound Sterling, all other variables remaining constant, would have affected shareholders' equity by approximately \$1.0 million at March 31, 2010.

The Company has a policy that permits the hedging of a portion of its net foreign currency cash flow. The overall approach to managing these exposures includes identifying and quantifying the exposure position, determining the desired exposure position, and designing an appropriate solution to reduce the exposure. The Company's derivative policy prohibits the use of derivative products for speculative purposes. In designing these solutions the Company may, from time to time, use financial derivatives.

During the first quarter of 2010, the Company did not enter into any forward currency contracts for its US denominated debt. The Company has a policy of only entering into derivative transactions with chartered banks.

### **6.3 Liability Insurance Risk**

Due to the nature of its core operating business, Vector may be subject to liability claims arising out of accidents or disasters involving aircraft on which Vector performs MRO services, including claims for serious personal injury or death. There can be no assurance that Vector's insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material. Additionally, any accident or disaster involving a previously serviced aircraft by Vector may significantly harm Vector's reputation, which would have a material adverse effect on Vector, its business, results from operations, financial condition and future prospects.

### **6.4 Other risks and uncertainties**

A detailed discussion of the Company's other risks and uncertainties are provided in the MD&A for the year ended December 31, 2009.

## **7 OFF BALANCE SHEET ARRANGEMENTS**

The Company has not entered into any off balance sheet arrangements, other than previously disclosed, that have or are reasonably likely to have an impact on the current or future results of operations or of the financial condition of the Company.

## **8 TRANSACTIONS WITH RELATED PARTIES**

The Company had no material transactions with related parties in the first quarter of 2010 and 2009. All related party transactions were in the normal course of business.

## **9 CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") requires the Company to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Company evaluates its estimates on an on-going basis, including bad debts, inventories, work in progress, investments, prepaid expenses, intangible assets, goodwill, future income taxes, litigation, and other contingencies. These estimates are based on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions.

The accounting policies that have had, or will have, a significant impact on the Company's reported earnings are discussed below:

- For management and financial statement purposes, the Company evaluates the carrying value of inventory and work in progress to determine if provisions are necessary to reduce such carrying amounts to net realizable value or replacement cost as set out in its accounting policies. Estimated future demand, as well as market conditions and external values of inventory items, are evaluated in the determination of net realizable value or replacement cost. If actual market conditions or demand are less favorable than those projected, additional inventory and work in progress provisions may be required. Actual net realizable value or replacement cost could differ materially from estimates made by management for inventory and work in progress valuation purposes.
- The Company follows the liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that management determines it is more likely than not that the future income tax assets will be realized. At March 31, 2010, the Company and its subsidiaries had income tax losses of approximately \$4.0 million in Canada, US\$0.1 million in the United States, £6.5 million in the United Kingdom and approximately ZAR18.4 million in South Africa, which are available to reduce taxable income in those jurisdictions in future years. The Company has recorded a valuation allowance against the future tax asset associated with the income tax losses in Canada, the United States, United Kingdom and South Africa. At March 31, 2010, the valuation allowance related to the income tax losses carried forward amounts to \$1.7 million. Future changes in the valuation allowance will be based on changes in management's assessment of the likelihood of realizing the future tax asset and will directly affect income tax expense and therefore net income of the Company.
- The Company recognizes revenue when there is persuasive evidence of an arrangement with a customer; the services or products have been performed or delivered to the customer; the sales price is fixed or determinable; and collection is probable. For certain contracts that extend beyond nine months, revenue is recognized when specific work segments as agreed by the customer are completed. Anticipated losses, if any, are fully provided for in the period in which they become apparent. Payments received in advance from customers are recorded as deferred revenue.

Other significant judgments and estimates used in the preparation of the Company's financial statements are noted below:

- The accounting policy for goodwill requires an ongoing assessment of the carrying value of goodwill. As of March 31, 2010, Vector concluded that there was no impairment in the carrying value of goodwill.
- The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of its customers were to deteriorate resulting in an impairment of their ability to make payments, additional allowances may be required.

- ES-UK and HS-UK maintain separate defined benefit pension plans for certain of its employees in the United Kingdom. The Company maintains defined contribution pension plans for the balance of its employees in North America and the United Kingdom. Pension related expenses and liabilities for the defined benefit pension plans for current employees are based upon assumptions regarding future compensation increases, return on plan assets, and discount rates. In addition, the value of the pension plan assets is impacted by equity and debt market conditions and global economic conditions. If these assumptions differ from actual performance in the future, or if management changes these assumptions, or of the return on funds invested as less than assumed then the future pension related expenses and liabilities for the defined benefit pension plans would be impacted.

## **9.1 Future Accounting Pronouncements**

### **9.1.1 International Financial Reporting Standards ("IFRS")**

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines that publicly accountable enterprises in Canada will be required to apply IFRS in full and without modification, beginning January 1, 2011. The Company will continue to present its results for fiscal 2010 using Canadian GAAP. The Company's expected IFRS transition date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for the year ended December 31, 2010, and of the amounts reported on the Company's opening IFRS balance sheet as at January 1, 2010. To accomplish this, in 2010, the Company will effectively maintain two parallel books of account.

The Company is continuing to assess the financial reporting impacts of adopting IFRS in 2011. The full impact on the future financial position and results of operations of the Company is not reasonably determinable or estimable at this time. The Company does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is identifying and assessing these additional disclosure requirements, as well as systems changes that will be necessary to compile the required disclosures.

The Company commenced its IFRS Conversion Project in 2008 and has established a formal project governance structure which includes the audit committee, senior management and external advisors. Project teams from each of the Vector subsidiaries will also be created comprising of both internal resources and external consultants. Project progress reports are to be provided to the Company's Audit Committee on a quarterly basis.

The Company's IFRS Conversion Project consists of four phases:

- Preliminary Diagnosis, Planning and Definition of Scope
- Detailed Evaluation
- Definition and Design of the Solution
- Implementation

The Company has completed the preliminary diagnostic and is currently in the process of reviewing the detailed diagnostic, defining the scope and finalizing the project team comprised of internal resources and external consultants.

The areas of accounting difference of highest potential impact to the Company, based on existing IFRS as at March 31, 2010, were identified to include property, plant and equipment; provisions and contingent liabilities; employee benefits; impairment of assets; income taxes; business combinations; foreign currency translation and initial adoption of IFRS under the provisions of IFRS 1, First-Time Adoption of International Financial Reporting Standards ("IFRS 1").

Detailed Evaluation is currently underway and involves detailed diagnostics and evaluation of the financial impacts of various options and alternative methodologies; initial staff training and audit committee orientation; analysis of IFRS 1 optional exemptions and mandatory exceptions to the general requirement for full retrospective application upon transition; as well as an assessment of the potential impact on financial reporting, accounting policies, systems, internal control over financial reporting, covenants and business activities.

The International Accounting Standards Board will continue to issue new accounting standards during the period of conversion. Since the Company has only just commenced the detailed evaluation phase, the final impact of IFRS on the Company's consolidated financial statements will only be determined once all applicable standards at the conversion date are known.

Definition and Design of the Solution involves identification and design of operational and financial business processes; summarization of 2011 IFRS disclosure requirements; a detailed analysis of the differences between IFRS and Canadian GAAP; establishing issue specific work teams to focus on quantification of impact, generating options and making recommendations in the identified risk areas and changes in policies; creation of accounting policies; establishing a staff communication plan, developing further staff training programs and evaluating the impact of the IFRS transition on other business activities, information systems and processes; and the development of required solutions to address identified issues.

Implementation will involve the execution of changes to information systems and business processes; completion of formal authorization processes to approve recommended accounting policy changes; and further training programs across the Company's finance and other affected areas, as necessary. It will culminate in the collection of the necessary financial information to compile IFRS compliant financial statements and reconciliations; embedding of IFRS in business processes; and audit committee approval of IFRS-compliant interim and annual financial statements for 2011.

Differences between IFRS and Canadian GAAP, in addition to those referred to below under "Accounting Policy Impacts and Decisions", may still be identified based on further detailed analysis by the Company and other changes in IFRS prior to the Company's conversion to IFRS in 2011.

Accounting Policy Impacts and Decisions: The Company is progressing through its initial assessment of the impacts of adopting IFRS based on the standards as they currently exist, and identified the following as having the greatest potential to impact the Company's accounting policies, financial reporting and information systems requirements upon conversion to IFRS.

#### (a) Property Plant and Equipment

IFRS and Canadian GAAP contain the same basic principles of accounting for property, plant and equipment; however, differences in application do exist. For example, capitalization of directly attributable costs in accordance with IAS 16, Property, Plant and Equipment ("IAS 16") may require measurement of an item of property, plant and equipment upon initial recognition to include or exclude certain previously recognized amounts under Canadian GAAP. Specifically, there may be changes in accounting for:

- i) the amount of capitalized overheads;
- ii) the capitalization of major inspections that were previously expensed under Canadian GAAP;
- iii) the capitalization of depreciation for which the future economic benefits of that asset are absorbed in the production of another asset; and
- iv) the capitalization of borrowing costs in accordance with IAS 23, Borrowing Costs.

IAS 16 also requires an allocation of the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and the depreciation of each such part separately. This method of componentizing property, plant and equipment may result in an increase in the number of component parts that are recorded and depreciated and, as a result, may impact the calculation of depreciation expense. Upon transition to IFRS, an entity has the elective option to reset the cost of its property, plant and equipment based on fair value in accordance with the provisions of IFRS 1, and to use either the cost model or the revaluation model to measure its property, plant and equipment subsequent to transition.

The final extent of the impact of applying IAS 16 by the Company and elective options with respect to accounting for its property, plant and equipment upon transition to IFRS, cannot be made at this time pending further review.

#### (b) Provisions and Contingent Liabilities

IAS 37, Provisions, Contingent Liabilities and Contingent Assets ("IAS 37") requires a provision to be recognized when: (i) there is a present obligation as a result of a past transaction or event; (ii) it is probable that an outflow of resources will be required to settle the obligation; and (iii) a reliable estimate can be made of the obligation. Under Canadian GAAP, the criterion for recognition is "likely", which is a higher threshold than "probable". It is possible, therefore, that some contingent

liabilities which would meet the recognition criterion under IFRS would not have been recognized under Canadian GAAP.

### (c) Employee Benefits

IAS 19, Employee Benefits ("IAS 19") requires the past service cost element of defined benefit plans to be expensed on an accelerated basis, with vested past service costs being expensed immediately and unvested past service costs being recognized on a straight-line basis until the benefits become vested. In addition, actuarial gains and losses are permitted under IAS 19 to be recognized directly in equity rather than through earnings, and IFRS 1 also provides an option to recognize immediately in retained earnings all cumulative actuarial gains and losses existing as at the date of transition to IFRS. Under Canadian GAAP, past service costs are generally amortized on a straight-line basis over the expected average remaining service period of active employees in the defined benefit plan.

The Company and its subsidiaries maintain two defined benefit pension plans which will be subject to different accounting treatment under IFRS as compared to Canadian GAAP. The full extent of the impact of applying IAS 19 cannot be made at this time, pending further review.

### (d) Impairment of Assets

IAS 36, Impairment of Assets ("IAS 36") uses a one-step approach for testing and measuring asset impairments, with asset carrying values being compared to the higher of value in use and fair value less costs to sell. Value in use is defined as being equal to the present value of future cash flows expected to be derived from the asset. In the absence of an active market, fair value less costs to sell may also be determined using discounted cash flows. The use of discounted cash flows under IFRS to test and measure asset impairment differs from Canadian GAAP where undiscounted future cash flows are used to compare against the asset's carrying value to determine if impairment exists. This may result in more frequent write-downs in the carrying value of assets under IFRS since asset carrying values that were previously supported under Canadian GAAP based on undiscounted cash flows may not be supported on a discounted cash flow basis under IFRS. However, under IAS 36, previous impairment losses may be reversed where circumstances change such that the impairment has reduced. This also differs from Canadian GAAP, which prohibits the reversal of previously recognized impairment losses.

As the majority of the Company's assets are owned by subsidiaries and the extent of any impairment losses will be primarily subject to the continued ability of the subsidiaries to recover costs through their business cash flows. The Company's assets will be subject to the one-step approach under IFRS for testing and measuring asset impairments which may result in some impairments being recognized or reversed under IFRS that would not have been required or permitted under Canadian GAAP.

#### (e) Income Taxes

IAS 12, Income Taxes ("IAS 12") prescribes that an entity account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Therefore, where transactions and other events are recognized in earnings, the recognition of deferred tax assets or liabilities which arise from those transactions should also be recorded in earnings. For transactions that are recognized outside of the statement of earnings, either in other comprehensive income or directly in equity, any related tax effects should also be recognized outside of the statement of earnings.

The most significant impact of IAS 12 on the Company will be derived directly from the accounting policy decisions made under IAS 16 and IAS 40. Therefore, the impact on the Company of accounting for the tax consequences of transactions and other events under IFRS versus Canadian GAAP cannot be fully determined at this time pending further review.

#### (f) Business Combinations

Under IFRS 3, Business Combinations ("IFRS 3"), business combinations must be accounted for by applying the acquisition method. One of the parties to a business combination can always be identified as the acquirer, being the entity that obtains control of the other business. Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Vector, as an acquirer, shall identify the date on which it obtains control of an acquiree. This date is usually the closing date of the acquisition, which would generally be the date on which the Company legally transfers the consideration or acquires the assets and assumes the liabilities of the acquiree. As of the date on which it obtains control, Vector shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree in accordance with IFRS 3. In accordance with IFRS 3, acquisition-related costs incurred to effect a business combination shall be expensed in the period the costs are incurred. Under IFRS, these costs are not permitted to form a component of goodwill as is permitted under Canadian GAAP. Under IFRS 1, an entity has the option to retroactively apply IFRS 3 to all business combinations or may elect to apply the standard prospectively only to those business combinations that occur after the date of transition. The Company currently intends to avail itself of the elective exemption under IFRS 1 which removes the requirement to retrospectively restate all business combinations prior to the date of transition to IFRS. The above are not expected to have an impact on the Company's consolidated financial position upon transition to IFRS.

#### (g) IFRS 1, First-Time Adoption of International Financial Reporting Standards

IFRS 1 provides the framework for the first time adoption of IFRS and specifies that, in general, an entity shall apply the principles under IFRS retrospectively. IFRS 1 also specifies that the adjustments that arise on retrospective conversion to IFRS from other GAAP should be directly recognized in retained earnings. Certain optional exemptions and mandatory exceptions to retrospective application are provided for under IFRS 1. The Company has not yet completed an analysis of IFRS 1 exemptions.

#### (h) Internal Controls over Financial Reporting and Disclosure

In accordance with the Company's approach to the certification of internal controls required under Canadian Securities Administrators' National Instrument 52-109, all entity level, information technology, disclosure and business process controls will require updating and testing to reflect changes arising from the Company's conversion to IFRS. Where material changes are identified, these changes will be mapped and tested to ensure that no material deficiencies exist as a result of the Company's conversion to these new accounting standards.

#### (i) Information Systems

It is anticipated that the adoption of IFRS may have an impact on information systems requirements. The Company has not yet assessed the need for systems upgrades or modifications to ensure an efficient conversion to IFRS.

The IASB has a number of on-going projects on its agenda, that may result in changes to existing IFRS prior to the Company's conversion in 2011. The Company continues to monitor these projects and the impact that any resulting IFRS changes may have on its anticipated accounting policies, financial position or results of operations under IFRS for 2011 and beyond.

### 9.1.2 Business Combinations

In January 2009, the CICA issued three new accounting standards: Section 1582, Business Combinations, Section 1601 Consolidated Financial Statements, and Section 1602, Non-Controlling Interests. These three financial standards will be effective for financial statements related to fiscal years beginning on or after January 1, 2011. The Company is currently assessing the implications of these new standards.

Section 1582, Business Combinations, supersedes Section 1581, Business Combinations, and sets out recognition standards for business combinations. The term "business" is more broadly defined than in the existing standard. It establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; recognizes and measures the goodwill acquired or a gain from a bargain purchase; requires acquisition costs to be expensed; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Section constitutes the Canadian equivalent to International Financial Reporting Standard IFRS3, Business Combinations. The Section applies prospectively to business combinations for which the acquisition date occurs at the beginning of the first annual fiscal year beginning on or after January 1, 2011.

### 9.1.3 Consolidated Financial Statements and Non-Controlling Interests

Section 1601 and 1602 supersede former Section 1600, Consolidated Financial Statements. Section 1601, which sets out standards for the preparation of consolidated financial statements, is effective for interim and annual consolidated financial statements related to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination,

and will be converged with the requirements of IAS 27, "Consolidated and Separate Financial Statements", for non-controlling interest, and is effective for interim and annual consolidated financial statements beginning on or after January 1, 2011. Management is reviewing the new pronouncement for any possible impact on the Company's financial statements.

## 10 CONTROLS AND PROCEDURES

### 10.1 Internal controls over financial reporting

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2010 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## 11 FINANCIAL INSTRUMENTS

The Company has operating lease commitments for equipment and facilities as at March 31, 2010 amounting to approximately \$29.7 million (2009 - \$34.8 million). These amounts are mainly payable over the next ten years.

The Company periodically enters into derivative financial instruments, mainly foreign exchange contracts and interest rate swaps used to manage currency and interest rate risk. During the first quarter of 2009, the Company had two interest rate swap arrangements converting C\$20.0 million and US\$17.0 million of debt to a fixed interest rate of 4.33% and 5.37% respectively plus the Company's stamping fee which expired on November 30, 2009. As at March 31, 2010, the Company does not have any outstanding foreign exchange contracts or interest rate swap arrangements.

Many of the employees of ES-UK and HS-UK are covered by separate defined benefit pension plans. As at March 31, 2010, the Company reported an accrued asset relating to its defined benefit pension plans of both ES-UK and HS-UK of approximately \$2.3 million (December 31, 2009 – \$3.3 million). The reduction in the accrued defined benefit pension asset was a result of changes in the foreign exchange rates and the difference between pension expense and pension funding.

During 2008, the Company established a defined benefit pension plan for the employees of Helicopter Services – UK ("**HS-UK Plan**") as part of the acquisition of the DARA Rotary Wing and Components business. The employees of DARA were given the option to transfer their historic pension entitlement to the HS-UK Plan or leave it with the United Kingdom Government. The historic liabilities of those employees who opted to transfer their historic pension entitlement has now been fully funded by the United Kingdom Government based on an actuarial valuation. The Company is responsible for funding the HS-UK Plan for all employees commencing April 1, 2008. At March 31, 2010, the Company had an accrued pension liability of approximately \$4.3 million related to the ES-UK pension plan which has been included as part of the net accrued pension asset noted above.

## **12 OUTLOOK**

### **12.1 Short-Term**

The Company will continue to focus its efforts on improving productivity to enhance profitability in each business segments. Additionally, the Company will look to expand its customer reach by partnering with OEMs as an integrated solution provider. The Company expects that the global economic slowdown will continue to negatively impact certain areas of its commercial business. The Company anticipates that new revenues will be generated in the short term from geographic expansion of its customer base and the pursuit of military opportunities.

Overall, the Company anticipates that revenues and operating earnings for 2010 will improve over those of 2009 based on increased revenues related to military opportunities and increased market share in certain products, assuming no further negative impact from changes in foreign exchange rates.

Results from Vector's operations for 2010 will be impacted by the British Pound Sterling/Canadian dollar and US dollar/Canadian dollar exchange rates when reporting in Canadian dollars.

The Company will continue to monitor cash flows through the management of working capital to ensure it maintains adequate levels of liquidity.

As a result of the completion of the public offering as discussed in section 5.6, the Company, further enhanced its balance sheet position. The Company continues to have a very strong balance sheet and is well positioned to pursue growth opportunities. To this end, the Company continues to evaluate growth opportunities, both internal and external, and believes that the future prospects for Vector remain positive.

### **12.2 Medium to Long-Term**

The Company will continue to focus on executing its business strategy through product line diversification, global expansion, and providing quality service. The Company will manage business risks and will consider investment opportunities in the aviation MRO industry with the aim of enhancing long-term shareholder value.

The Company further anticipates that earnings from HS-UK (in its native currency) will improve as benefits from efforts to improve operational efficiencies are realized. In the longer term the Company aims to increase revenues at HS-UK from the expansion of its customer base and by adding new product lines.

The Company anticipates that the P&WC 307/308 OEM overhaul and service facility agreement will add revenues and produce earnings in the longer term.

## **13 OTHER MD&A REQUIREMENTS**

### **13.1 Outstanding Share Data**

The authorized share capital of the Company consists of an unlimited number of first and third preference shares, issuable in series, and an unlimited number of common shares without par value. As at March 31, 2010, there were no preference shares issued and there were 46,012,873 common shares issued and outstanding.

The aggregate number of options and employee shares used under the Vector Employee Stock Option Plan and the Vector Employee Share Purchase Plan cannot exceed 10% of the issued and outstanding common shares of the Company at any point in time. As of March 31, 2010, 2,744,947 options are issued and outstanding under the Employee Stock Option Plan, 399,508 shares have been issued under the Employee Share Purchase Plan and 523,365 common shares have been issued upon exercise of options under the Employee Stock Option Plan.