

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*This Management's Discussion and Analysis ("MD&A") explains the financial condition and results of operations of Atlantis Systems Corp. ("our Company" or "we" or "our" or "us" or "ASC") as at and for the three months ended March 31, 2009 with comparisons to the three months ended March 31, 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 ended March 31, 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 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 May 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.

“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 Tecresult 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.

“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 First Quarter of 2009**

- 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. Subsequently, the Company was notified that the balance of the refundable tax credits have been approved for payment.
- In January 2009, we announced that we had received 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.
- In January, 2009 we signed a teaming agreement with a major Canadian customer, and subsequent to the signing of the teaming agreement, the customer was awarded a contract for a major Canadian integrated military training program. The contract calls for delivery of a comprehensive aircrew training equipment and services solution. The contract is valued at over \$300 million which will be shared by the various team members including Atlantis. Atlantis expects to contribute both flight training devices and courseware to this program. We have subsequently received a commitment letter from the customer for up to \$240 to begin preliminary work on this project while contract negotiations continue.
- In February 2009, we announced that ASA, our wholly-owned U.S. subsidiary, had 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 created to quickly procure the next generation of simulation and training products and services for use by the U.S. and coalition service members. STOC II is valued at U.S.\$ 17.5 billion over the next 10 years and ASA’s qualification gives it the opportunity to pursue, bid, win and execute contracts with the U.S. Army in connection with STOC II.
- In the first quarter of 2009 our ASE division was awarded four additional e-learning projects for approximately \$307, in total, and ASI was awarded contract amendments for \$376 to upgrade the CPT delivered last year to the RDAF.
- Throughout the first quarter of 2009 we have continued to successfully implement our cost reduction initiatives without impacting the Company’s ability to execute current contracts or pursue identified new opportunities.

## **Recent Developments**

- In April 2009, the Company 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.
- On December 15, 2008, the Company announced that the TSX had placed the Company under a delisting review as result of a decline in the market value of the Company’s shares and concerns regarding the Company’s financial condition. The Company is being 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 informed the Company on April 9, 2009 that the TSX has determined to defer its delisting decision until July 3, 2009. The Company will be permitted to make further submissions to the TSX regarding this matter on or before June 29, 2009. The Company will continue to work on remedying its continued listing deficiencies but there can be no assurances that it will be able to do so by July 3, 2009. The Company is investigating alternatives if its common shares are delisted from the TSX.
- ComVest Capital, LLC (“ComVest”) has recently informed the Company that effective April 1, 2009, ComVest will begin charging an additional default interest of 5% per annum.

### ➤ **Summary of the First Quarter 2009 Results and Other Information**

- Revenue for the three months ended March 31, 2009 was \$3.9 million, a 9.3% decrease from the revenue of \$4.3 million in the first quarter of the prior year. Revenue in the first quarter of 2009 includes net revenues of \$921 due to reconfigured cost estimates to complete the SMHP and the CFTS 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.
- Net loss for the three months ended March 31, 2009 was \$0.1 million, compared to a net loss of \$2.3 million in the same period in 2008. The net loss in the first quarter of 2009 was reduced by approximately \$1.3 million for OMDC refundable tax credits, net of applicable fees.
- Order backlog at March 31, 2009 was \$29.1 million, which includes \$17.7 million for the CFTS support services to be recognized over the next 19 years, and \$7.0 million for the SMHP. The order backlog is unchanged from \$29.1 million at December 31, 2008, which included approximately \$17.4 million for CFTS support services, and \$7.7 million for the SMHP.

As at March 31, 2009, the Company was not in compliance with a covenant in its financing arrangement with ComVest relating to a requirement for a minimum EBITDA to Fixed Charges ratio. In addition, as at March 31, 2009, the Company had exceeded the maximum borrowing

limit per the terms of its agreement with ComVest. ComVest has agreed to waive compliance for the reporting periods ended March 31, 2009 and December 31, 2008 for both the breach of covenant and exceeding the maximum borrowing limit. In order to secure these waivers the Company's board of directors agreed to re-price, subject to regulatory approval, 9,300,000 warrants to purchase common shares from \$0.09 to \$0.03 per share that were granted to ComVest pursuant to its agreement with ComVest ("ComVest Warrants"). This warrant re-pricing is in lieu of covenant waiver fees that would have been otherwise charged by ComVest for covenant waivers as of March 31, 2009 and, December 31, 2008. The re-pricing of the ComVest Warrants was approved by the TSX on April 9, 2009.

## 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 May 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.

More recently, and as discussed further in “Our New Strategic Direction” section of this MD&A, we have changed our strategic focus and positioning to leverage our core competencies in order to broaden the value we provide to our military and energy sector customers. We believe that our core competencies can be targeted to the whole of our customers’ value-chain, not just training, by providing simulation solutions as early as product design, assisting with rapid prototyping, supporting end-user sales, and continuing through to the delivery of our traditional training systems.

We are headquartered in Brampton, Ontario and maintain offices in Orlando, Florida and 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.

The U.S. military market, while very large, has been difficult to penetrate. Unless a sizeable U.S.-based contract is obtained sufficient to sustain our U.S. operations, we expect to exit this market within the coming year.

### *Energy*

Globally, the nuclear power industry is entering a significant growth phase, with more than 40 new reactors under construction and more than 350 are planned or proposed. In Ontario alone, it is estimated that \$26 billion will be spent on the building of new nuclear facilities and the rehabilitation of existing operations over the next 20 years. This expected growth has created a significant human resources challenge for the industry as a high percentage of skilled operators and other employees are nearing retirement age. In Canada, for example, 38% of the workforce is over the age of 50.

Atlantis secured its first order for this market in 2006 and currently has four active projects to support training systems for nuclear technicians and operators. In the third quarter of 2008, we delivered an IMTS as a prototype for training technicians in power plants. This contract was awarded by a major partner in the energy sector for approximately \$450. In the second quarter of 2008, we announced a partnership with the PWUTI to create Powertrain. We are in the process of renegotiating this agreement.

### *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.

Over the last several years, we have invested in developing the HVTT, our virtual-reality, full-motion helicopter simulator, in order to provide full flight simulation training at a fraction of the cost of full flight simulators. We are actively searching for the appropriate partner to commence field testing.

#### *Other Potential Markets*

We believe that there are numerous other markets that would benefit from our synthetic learning systems. These include the 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 are now targeting the whole of our military and energy sector customers' value-chain, not just training, which has historically been our focus. We implemented strategic account management practices in order to better focus our business development and research and development activities with a view to capitalize on additional opportunities to use simulation methods to service the full life cycle of our customers' products. We plan to provide our

simulation solutions commencing with product design, assisting with rapid prototyping, supporting end-user sales, and continuing through to the delivery of our traditional training systems. This strategy will allow our customers to better develop end-user capabilities and improve their asset utilization.

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, 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 \$4.5 million in new business, including a \$1.3 million e-learning contract with the DND and subsequent to the end of the first quarter a \$2.0 million e-learning contract with L-3 MAPPS to be a subcontractor for a project with the Canadian Navy. In addition, the Company signed in the first quarter of 2009 a teaming agreement with a major Canadian customer. Subsequent to the signing of the teaming agreement, the customer was awarded a contract for a major Canadian integrated military training program. The contract calls for delivery of a comprehensive aircrew training equipment and services solution. The contract is valued at over \$300 million and will be shared by the various team members including Atlantis. Atlantis expects to contribute both flight training devices and courseware to this program and has received a commitment letter from the customer for \$240 to begin preliminary work.

While we have not significantly increased our investment in the nuclear/energy market, we have devoted considerable effort and time to Powertrain and our relationship with PWU/PWUTI, clarifying our respective interests and defining a common vision for our business model. We expect that the current agreement will be revised in the near future for the benefit of both parties.

Over the next few months our priorities are as follows:

- recapitalize the Company;
- further reduce our cost structure;
- aggressively seek out new business;
- define a clear nuclear strategy.

## 7. OTHER COMPANY INFORMATION

We are registered under a number of quality management programs including ISO 9001:2000, AS9100:2004, CSA-Z299.1-1985, Boeing BQMS D6-82479 and Rockwell Collins RC-9000, among others.

We operate in the U.S. through our wholly-owned subsidiary ASA. We operate in Canada and the rest of the world through our wholly-owned subsidiary ASI, and through ASE, a division of ASC.

At March 31, 2009, we had a total head count of 121 of which 22 were based at ASA in Orlando, Florida and 26 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 has secured waivers without a fee for the applicable reporting periods prior to December 31, 2008. 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 waivers for the March 31, 2009 and December 31, 2008 reporting periods. The re-pricing of the ComVest Warrants was approved by the TSX on April 9, 2009.

The Company has been advised by ComVest that effective April 1, 2009, ComVest will begin 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 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 been 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 has determined to defer its delisting decision until July 3, 2009. The Company will be permitted to make further submissions to the TSX regarding this matter on or before June 29, 2009.

If the Company cannot satisfy the TSX that the deficiencies have been rectified, it may determine to delist the Company's common shares. In such event, the TSX would issue written notice to the market as to the date the delisting would be effective, which would generally be 30 days after the written notice.

In connection with the TSX notification of its delisting review, ComVest confirmed to the TSX that it did not then have any intention of enforcing any of its default rights and remedies under the ComVest Agreement through to the end of the original delisting review period on April 13, 2009, and that ComVest would have notified the TSX, at the same time it provided any notice to the Company, in the event ComVest had determined to exercise any such rights or remedies. ComVest has not confirmed any similar intentions with respect to the extended period for the delisting review.

The Company will continue to work on remedying its continued listing deficiencies but there can be no assurances that it will be able to do so by July 3, 2009. The Company is investigating alternatives if its common shares are delisted from the TSX.

## **10. 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 in the first quarter of 2009 by approximately \$0.7 million due to the inflation escalation clause.

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

Throughout the first quarter of 2009, we have continued to deliver on our commitments under the CFTS program. To date we have recognized revenues of \$16.8 million, \$26.3 million, \$22.7 million, \$4.6 million and \$1.1 million in 2005, 2006, 2007, 2008 and the first quarter of 2009, respectively, for a total of \$71.5 million. As of March 31, 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 \$19.4 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.

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 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. In order to ensure that we maximize the potential of this opportunity and offer optimal customer service we have agreed to embed an Atlantis team at the Southport facility in the second quarter of 2009.

## **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 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 the landlord to

negotiate rent relief at the Kenview location, implemented additional layoffs, eliminated quarterly audit reviews and reduced the cash outflow on severance payments by unilaterally reducing the payout by 50% and increasing the payout period to offset the reduced payout amount. Through March 31, 2009, the cost reductions we have achieved as a result of these further cost reduction initiatives are consistent with our original estimate.

To date, the cost reductions 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. The Company will continue with its cost reduction efforts, and to this end, we are closely scrutinizing our U.S. operations. Unless ASA can generate sufficient self-sustaining business in the near future, we expect to close the Orlando facility by the end of 2009.

## **12. 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.

## **13. RESULTS OF OPERATIONS**

The following is a discussion of the material factors influencing the operating results and the financial condition of our Company, as at, and for the period ended March 31, 2009 with comparisons to the year ended December 31, 2008, where applicable, and the operating results for the three-month period ended March 31, 2009 with comparisons to the three-month period ended March 31, 2008, where applicable.

The Consolidated Statements of Operations, Comprehensive Loss and Deficit for the three months ended March 31, 2009, with comparative numbers for the same period in 2008, reflect the operations of our operating entities, ASI, ASA and ASE (a division of ASC) and corporate overheads. .

## Summary Financial Information

	Three Months Ended March 31,	
	2009 \$	2008 \$
Revenues	3,934	4,339
Gross margin	2,388	147
Gross margin percentage	60.7%	3.4%
Operating expenses <sup>(1)</sup>	1,753	1,841
Depreciation and amortization	392	530
Interest expense and financing costs (net)	354	78
Net (loss)	(111)	(2,302)
Net (loss) per share (basic)	(0.00)	(0.04)
Total assets at end of period	9,300	26,014
Total long-term financial liabilities at end of period <sup>(2)(3)</sup>	-	-

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

<sup>(2)</sup> 2008 excludes a prior term loan of \$2,660 included in current liabilities.

<sup>(3)</sup> 2009 excludes the ComVest Term Loan of \$2,074 included in current liabilities.

## 14. 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 three months ended March 31, 2009 the Company incurred a net loss of \$111, and has a working capital deficiency of \$6,256, a deficit of \$102,491 and a shareholders' deficiency of \$3,332 as at March 31, 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 has determined to defer its delisting decision until July 3, 2009. The Company will be permitted to make further submissions to the TSX regarding this matter on or before June 29, 2009. If the Company cannot satisfy the TSX that the deficiencies have been rectified, it may determine to delist the Company's common shares. In such event, the TSX would issue written notice to the market as to the date the delisting would be effective, which would generally be 30 days after the written notice.

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 three months ended March 31, 2009 are not necessarily indicative of the results to be expected for any future periods.

## 15. REVENUE

The components of revenue for the three months ended March 31, 2009 and 2008 are as follows:

	Three Months Ended March 31,					
	2009		2008		Change	
	\$	%	\$	%	\$	%
<b>CFTS</b>	1,055	27%	1,789	41%	(734)	-41%
<b>SMHP</b>	1,048	27%	549	13%	499	91%
<b>US Defense Contractor</b>	472	12%	356	8%	116	32%
<b>RDAF</b>	265	7%	852	20%	(587)	-69%
<b>Energy Sector</b>	167	4%	67	2%	100	150%
<b>IMTS</b>	50	1%	124	3%	(74)	-60%
<b>E-learning</b>	317	8%	-	0%	317	
<b>Other</b>	560	22%	602	13%	(42)	-7%
<b>Total</b>	3,934	108%	4,339	100%	(406)	-9%

Revenue for the three months ended March 31, 2009 as compared to the prior year decreased by \$406, or 9.3%. Revenue decreased in the first quarter of 2009 primarily due to the maturing of the CFTS program and the completion of the RDAF program in the third quarter of 2008. The components of the net decrease in revenue are summarized in the above table

Included in the first quarter of 2009 are revenues of \$543 from the SMHP due to reconfigured cost estimates to complete this program. Excluding this effect on revenue, SMHP revenue would have remained essentially unchanged from the prior period. In addition, included in the first quarter of 2009 are net revenues for the CFTS program of \$378 due to reconfigured cost estimates to complete this program and increases in forecasted support billings from the application of escalation clauses in the contract on current billings. However, in the first quarter of 2008, the effect of reconfigured cost estimates to complete the CFTS program decreased revenue by \$349. Excluding these effects on revenue, CFTS revenue would have decreased to \$677 from \$2,138 in the prior period. Furthermore, excluding such effects on all revenue, revenue would have decreased in the first quarter of 2009 by 36% to \$3,013.

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, as in the case of the SMHP program. When the contract value increases, as in the case of the CFTS program, the increase in contract value must be recognized as 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. To date \$71.5 million of revenues have been recognized 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 19 years.

We believe that our performance on the CFTS contract will lead to additional contracts with both the DND and the CF.

The contract with Sikorsky Aircraft Corp. (“Sikorsky”) is denominated in U.S. dollars and the contractual value has remained unchanged since the Eduplus acquisition. The net effect on quarterly revenues from the conversion to Canadian dollars at the appropriate exchange rates for the first quarter of 2009 and 2008 was not significant. However, the change in the U.S dollar to the Canadian dollar exchange rate at March 31, 2009, as compared to March 31, 2008, resulted in an increase of approximately \$1.2 million in the SMHP order backlog. The SMHP backlog at March 31, 2009 was \$7.0 million, as compared to \$8.3 million at March 31, 2008.

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.

E-learning revenues in the first quarter of 2009 include \$121 from the recently awarded \$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. The remaining revenues are from five smaller projects awarded to ASE in the first quarter of 2009, for in total, \$307. In addition, our recently announced contract with L-3 MAPPS for approximately \$2.0 million was awarded to ASE based on their demonstrated expertise in e-learning courseware development.

The Company recognized revenues of \$472 (2008: \$356) in the three months ended March 31, 2009 from contracts awarded to ASA from a U.S. defense contractor. Two of these contracts were awarded in the first quarter of 2008 and the initial contract was awarded in the third quarter of 2007.

In the third quarter of 2006, we were awarded a contract to provide a CPT to the RDAF for the

EH-101 helicopter. The initial production phase of the program was substantially completed in the third quarter of 2008. The revenue in the first quarter of 2009 of \$265 was due to a recently awarded contract amendment to provide enhancements to the CPT.

Revenues from customers in the energy sector increased in the first quarter of 2009 to \$167, a 150% increase over the same period in the prior year. We currently have four active contracts for hardware and software engineering services in order to support training services for nuclear technicians and operators, two of which were received subsequent to the first quarter of 2008. Management continues to believe that the energy sector will become increasingly important to the Company's financial performance.

IMTS revenues from the aerospace sector have decreased over each of the last four years as various IMTS programs have matured or were completed. In the three months ended March 31, 2009, revenues from IMTS for aerospace programs decreased to \$50, or 1% of total revenues, as compared to \$124, or 3% of total revenue, for the same period in 2008. Neither period's IMTS revenues reflect any IMTS component of the CFTS contract. IMTS revenues in the first quarter of 2009 represent revenues from the support phases of the RAAF contract, completed in 2007, and a contract to provide weapons load trainers to the CF, the initial production phase of which was substantially completed in the first quarter of 2008. We believe that ITMS remains an important product offering for the aerospace sector and that long-term delays in large programs are primarily responsible for the extended decline in revenues

Other revenues in the three months ended March 31, 2009 and 2008, of \$560 and \$602, respectively, were derived from multiple, small and short-duration contracts.

During the quarter ended March 31, 2009, we had three customers that represented more than 10% of revenue as follows: the CF with 31% (2008: 41 %) Sikorsky with 29% (2008: 13%); and a U.S. defense contractor with 12% (2008: 8%). As at March 31, 2009, two customers represented more than 10% of combined trade receivables and unbilled revenue as follows: Sikorsky with 55% (2008: 22%); and the RDAF with 16% (2008: 44%).

The order backlog at March 31, 2009 of \$29.1 million includes \$19.4 million from the CFTS program (with approximately \$17.7 million for future support services), \$7.0 million from the SMHP and \$2.7 million from all other contracts. The order backlog at March 31, 2009 was unchanged from the December 31, 2008 amount (which included \$17.4 million in future support services). The unchanged backlog was due to offsetting the first quarter revenue of \$3.9 million with the following increases in order backlog: new contracts and contract amendments awarded in the first quarter of 2009 of approximately \$2.5 million; the gross increase (before revenue is recognized on a percentage of completion basis) of approximately \$0.3 million in the SMHP backlog from the conversion of this U.S. dollar denominated contract to Canadian dollars; the gross increase of approximately \$0.7 million from increases in the CFTS contract (see "The CFTS Program"); and test equipment sales as well as revenue from small contracts of approximately \$0.4 million.

The order backlog at March 31, 2009 has decreased \$5.7 million from the comparable backlog of \$34.8 million at March 31, 2008 (which included \$18.0 million in future support

services). This order backlog decrease consists of a \$2.3 million net reduction in the CFTS program, a \$1.9 million net reduction in programs with a U.S. defense contractor, a \$1.3 million net reduction in the SMHP, a \$0.9 million net reduction in the RDAF program; and a \$0.7 million net increase in order backlog from all other programs. The reduction in backlog is primarily due to continued revenue recognition on all the above named projects, offset, in part, by the following: new contracts and contract amendments awarded, and in particular, the contract with the DND for \$1.3 million; a gross increase of approximately \$1.9 million in the SMHP backlog from the conversion of this U.S. dollar denominated contract to Canadian dollars; and a gross increase of approximately \$1.7 million from increases in the CFTS contract (see “The CFTS Program”).

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.

## 16. GROSS MARGIN

Gross margin for the quarter ended March 31, 2009 was \$2,388, or 60.7% of revenue as compared to gross margin of \$147, or 3.4% of revenue, for the same period in 2008.

Gross margin in the first quarter of 2009 includes a reduction in the cost of revenue due to the recognition of \$1,306 (2008: nil), net of applicable fees, from OMDC refundable tax credits, and a foreign exchange loss of \$248 (2008: \$37). In addition, the first quarter gross margin reflects the net increase in revenue of \$921 due to reconfigured cost estimates to complete the SMHP and CFTS program and the increases in forecasted support billings from the application of escalation clauses in the CFTS contract (see “Revenue”). However, in the first quarter in 2008, reconfigured cost estimates reduced gross margin by \$349.

Excluding for both periods the effect of refundable tax credits, foreign exchange and the update of program costs and support billings, the adjusted gross margin percentages for the first quarters of 2009 and 2008 would have been 13.6% and 11.4%, respectively. The higher adjusted gross margin percentage in 2009 is due to the higher gross margin percentages available from non-CFTS programs, offset by the impact of absorbing non-variable overhead on a lower adjusted revenue base. Revenues from the CFTS program, excluding the effect of updates to program costs and support billings, represented 22% and 46% of revenue for the first quarters of 2009 and 2008, respectively.

As discussed above, in the first quarter of 2009, we recognized a reduction of \$1,306 in our cost of revenue for refundable tax credits, net of applicable fees. The amount recognized was based on the amount approved for initial payment subsequent to an audit performed on the OMDC’s behalf. This amount, subsequently paid on April 15, 2009, represents approximately 90% of the amount originally estimated by the OMDC. After further auditor review of the eligibility of certain overhead costs, the Company was informed in May 2009, that the balance has been approved for payment. Management believes that at March 31, 2009, significant doubt then existed as to the collectability of this balance and has accordingly not accrued this amount for the first quarter of 2009.

## 17. OPERATING EXPENSES

We incurred G&A expenses of \$1,240 for the quarter ended March 31, 2009, a decrease of \$198 or 13.8%, as compared to same period in 2008. This decrease includes a net reduction of \$178 and \$20 at the Canadian operations and ASA, respectively. The effect of further cost reduction initiatives subsequent to March 31, 2008, was offset, in part, at our Canadian operations, by a net increase of \$267 in consulting and professional fees. This increase includes \$121 for services provided by related parties (see “Related Party Transactions”) and an additional \$60 for consulting fees incurred to retain the services of the Company’s interim CEO.

For three months ended March 31, 2009, S&M expenses were \$460, an increase of 25.3%, as compared to the prior period. This increase includes a net increase of \$69 and \$24 at the Canadian operations and ASA, respectively. The effect of further cost reduction initiatives subsequent to March 31, 2008 was more than offset at our Canadian operations by a \$76 increase in engineering costs allocated to marketing for work on proposals and the transfer from operations to marketing of a senior technical staff member. The increase in expense at ASA also reflects an increase in engineering costs allocated to marketing for work on proposals.

We recorded stock option expenses of \$53 for the quarter ended March 31, 2009 compared to \$36 for the same period in 2008.

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

## 18. OTHER ITEMS

We incurred depreciation and amortization expense for the first quarter of 2009 of \$392, a decrease of \$138 over the same period in 2008. This decrease is primarily due to the amortization expense of \$108 in the first quarter of 2008 for the HVTT deferred development costs. The HVTT deferred development costs were subsequently written off in fiscal 2008.

Interest expense and financing costs, net increased in the first quarter of 2009 by more than 350% to \$354 as compared to \$78 in the same period of 2008. The first quarter 2009 net expense includes interest expense of \$336 and finance and bank charges, support fees and other costs of \$43, offset, in part, by interest income of \$25. The 2008 first quarter interest expense and financing costs, net includes interest expense of \$48, and finance and bank charges, support fees and other costs of \$51, offset, in part, by \$21 of interest income.

During both quarters, the Company had approximately \$2.7 million in average gross term debt outstanding (excluding accretion). The proceeds of the ComVest Term Loan of approximately \$2.7 million received in May 2008 were used to substantially repay a term loan that was outstanding from September 2007. The difference of \$288 in the interest expense component is the result of higher interest rates on the ComVest Term Loan, the interest incurred on the utilization of the ComVest Operating Line, and a non-cash component of \$125 from an increase in the accretion associated with the original financing costs. The accretion results 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.

An amount of \$16 is included in the 2009 finance and bank charges related to the re-pricing of the ComVest Warrants. The expense was determined using the Black-Scholes pricing model to determine the difference in fair value of the original and re-priced warrants on the date the re-pricing of the warrants was approved by the Company's board of directors (See "ComVest Agreement" and "Liquidity"). In addition, the interest income in the first quarter of 2009 was primarily due to accrued interest on the OMDC refundable tax credits.

## 19. OTHER EXPENSES

There was no income tax (recovery) expense recorded for the three month periods ended March 31, 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-month periods ended March 31, 2009 and 2008, was offset by utilizing an equal portion of the unrecognized operating loss carry-forwards from previous years. As at March 31, 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. As of December 31, 2008 our US loss carry-forwards were approximately \$8,148 and will expire between 2024 and 2028.

## 20. NET LOSS

For the three months ended March 31, 2009, we recognized a net loss of \$111 or \$0.00 per share, as compared to a net loss of \$2,302, or \$0.04 per share, for the same period in 2008. The decreased loss of \$2,191 was primarily due to the net effect on gross margin of the following: the recognition in the first quarter of 2009 of \$1,306, net of applicable fees, of OMDC refundable tax credits; the net increase of \$1,270 in revenues due to reconfigured cost estimates and from increases in forecasted support billings for the SMHP and CFTS program; and the net decrease of gross margin of \$211 due to foreign exchange losses (see "Revenue and Gross Margin"). In addition, the decreased loss includes net reductions of \$88 and \$108 in operating expense and the amortization of the HVTT, respectively. The effect of these items was offset, in part, by the net increase in interest expense and financing costs of \$276.

### *Net Loss per Share*

As a result of the loss recorded in the first quarters of both 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.

## 21. SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

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

	2009	2008				2007			
	31-March \$	31-Dec \$	30-Sept \$	30-June \$	31-March \$	31-Dec \$	30-Sept \$	30-June \$	
Revenue	3,934	3,070	2,989	4,245	4,339	5,359	6,750	15,241	
Gross margin (deficit)	2,388	(69)	187	414	147	(314)	1,081	5,505	
Operating expenses <sup>(1)</sup>	1,753	2,577	1,919	1,920	1,841	2,483	2,425	2,730	
Net (loss) income	(111)	(16,248)	(2,530)	(2,337)	(2,302)	(3,334)	(1,594)	2,671	
Net (loss) income per share (basic)	(0.00)	(0.29)	(0.05)	(0.04)	(0.04)	(0.06)	(0.03)	0.05	
Net (loss) income per share (diluted)	(0.00)	(0.29)	(0.05)	(0.04)	(0.04)	(0.06)	(0.03)	0.05	
CFTS revenues	1,055	686	312	1,888	1,789	3,010	4,340	12,483	
Non-CFTS revenues	2,879	2,384	2,677	2,357	2,550	2,349	2,410	2,758	

<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 first quarter of 2009 is approximately 98% complete. As a result, quarterly revenues consistently declined beginning in the third quarter of 2007 and through to the third quarter of 2008, and then declined further in the first quarter of 2009.

The above table illustrates the correlation between quarterly revenues and the level of CFTS revenues. Quarterly revenues derived from other than the CFTS program have been relatively consistent, averaging approximately \$2.5 million for each of the last eight quarters, with the highest recorded at \$2,879 in the first quarter of 2009 and the lowest at \$2,349 in the fourth quarter of 2007.

The non-CFTS revenues in the first quarter of 2009 were increased by \$543 due to revised cost estimates for the SMHP. Non-CFTS revenues in the second and third quarters of 2007 include 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. Quarterly revenues beginning in the fourth quarter of 2007 through the fourth quarter of 2008 include relatively consistent contributions from the SMHP. In addition, we have generally experienced higher quarterly revenues since the first quarter of 2008 from the energy sector and from contracts with a large U.S. defense contractor.

In the second quarter of 2007, revenue levels reflected our general experience with large, multi-year contracts, in particular the CFTS program, whereby revenue would fluctuate with the proportion of work performed in-house and the achievement of milestones by our subcontractors in any given quarter. The second quarter of 2007 also includes additional revenue of approximately \$1,815 from the recalibration of total cost estimates on the CFTS program.

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

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, as well as other items that increased gross margin in 2009 by a further \$673 (see “Gross Margin”).

The fourth quarter losses were larger in both years 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 2008 and 2007, respectively. In addition, the fourth quarter of 2008 includes the write-off of goodwill and the HVTT, while the fourth quarter of 2007 included the largest quarterly decrease in gross margin (\$750) from reconfigured cost estimates to complete customer programs.

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 quarter of 2009 was further mitigated by further cost reduction initiatives in the fourth quarter of 2008. However, in the last two quarters of 2008 and the first quarter 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.

The additional revenue of approximately \$1,815 in the second quarter of 2007 from the recalibration of total cost estimates resulted in a corresponding increase in quarterly net income.

The quarterly net income (loss) per share (basic) 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 three quarters of 2007, fiscal 2008 or in the first quarter of 2009. As at March 31, 2009, the number of outstanding common shares was 55,993,929.

The diluted net income (loss) per share for all quarters with a net loss did not result in any dilution versus the reported basic earnings per share. Although there were dilutive securities in the second quarter of 2007, the calculated diluted earnings per share was unchanged from the basic earnings per share.

## CASH FLOW, LIQUIDITY AND CAPITAL RESOURCES

### 22. CASH FLOW SUMMARY

At March 31, 2009, we had bank indebtedness, net of cash, of \$4,930 as compared to bank indebtedness, net of cash, of \$62 at March 31, 2008. The sources and uses for the changes in cash, for the three-month periods ended March 31, 2009 and 2008, are as follows:

	Three Months Ended March 31	
	2009	2008
Cash flows provided by (used in)		
Operating activities	\$ (2,510)	\$ (3,622)
Investing activities	(14)	(20)
Financing activities	(321)	(140)
Foreign exchange gain on US\$ Term Loan	73	-
Increase (decrease) in cash	(2,772)	(3,782)
(Bank indebtedness) cash at beginning of period	(2,158)	3,720
(Bank indebtedness) cash at end of period	\$ (4,930)	\$ (62)

### 23. OPERATING ACTIVITIES

For the quarter ended March 31, 2009, cash outflows from operating activities of \$2,510 were primarily due to net cash outflows of \$2,983 from a net change in working capital. The net change in working capital was principally the result of an increase of \$2,298 and \$1,263 in receivables and unbilled revenue, respectively. The increase in receivables includes \$1,523 of OMDC tax credits, without considering accrued fees, related accrued interest and refundable capital tax, and an increase of \$775 in trade receivables due to a general increase in billable activity in the first quarter of 2009. The increase in unbilled revenue is primarily due to unbilled activity for the SMHP.

For the three months ended March 31, 2008, the cash outflows from operating activities of \$3,622 were primarily due to a net loss of \$2,302, which was decreased by non-cash charges of \$566 and increased by an outflow of \$1,880 from the net change in non-cash working capital. Non-cash charges to the operating results include depreciation and amortization as well as stock option expenses. The \$1,880 cash outflow on account of net changes in non-cash working capital was primarily due to an increase in trade and other receivables, an increase in unbilled revenue attributable to the contract with Agusta Westland, and a reduction in accounts payable.

## 24. INVESTING ACTIVITIES

For the first quarter of 2009 and 2008 the cash used in investing activities of \$14 and \$20, respectively, reflects 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. .

## 25. FINANCING ACTIVITIES

Cash outflows from financing activities were \$321 and \$140 for the first quarters of 2009 and 2008, respectively. Both cash outflows reflect the scheduled repayment of principal on outstanding term debt.

## 26. 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 March 31, 2009, \$5,019 (U.S. \$3,979) 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. 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.

As at 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 EDITDA 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). In addition, as at March 31, 2009, the Company had exceeded the maximum borrowing limit per the terms of the ComVest Agreement by approximately U.S. \$1,398. The Company had also exceeded the maximum borrowing limit at December 31, 2008 and September 30, 2008 by U.S. \$2,469 and U.S. \$665, respectively.

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. 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.

The Company has been advised by ComVest that effective April 1, 2009, ComVest will begin 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 been changed.

It is likely that the Company will continue to violate covenant requirements at future compliance dates. Therefore, the entire balance of the ComVest Term Loan has been classified as a current liability.

In the event of a default for a future compliance date that is not waived by ComVest, it is unlikely the Company could continue with operations as it is presently constituted. 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.

In January 2009, we were notified by the OMDC that we were 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 subsequently was notified that the balance has been approved for payment.

The Company's stock price has declined substantially in the past eight quarters and its closing price at May 14, 2009 on the TSX was \$0.035. 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.

## **27. CAPITAL RESOURCES**

### Stock Options

During the quarter ended March 31, 2009, the Company awarded no options to purchase shares of the Company under our stock option plan (the "Plan"). No options were exercised during the first quarter of 2009 and 559,799 stock options were either cancelled or expired

As at March 31, 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 7,047,108 options to purchase common shares outstanding, leaving 1,351,981 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 ended March 31, 2008, no options were issued under the Plan. In addition, no options were exercised and 95,675 options were cancelled or expired.

During the first quarter of 2009, the Company recorded a net stock option compensation expense of \$53 (2008 - \$36) for the combination of the vesting of existing options, the grant of new options and the recognition of options cancelled. The calculation of this 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 Company's board of directors agreed to re-price the ComVest Warrants, subject to regulatory approval, from \$0.09 to \$0.03 per share. The Company received TSX approval for the re-pricing on April 9, 2009. The expense related to re-pricing these warrants has been credited to warrants within the share capital account.

In the first quarter of 2009, no common share purchase warrants were exercised or expired.

In the three months ended March 31, 2008, no common share warrants were exercised, while there were 250,000 common share purchase warrants that expired.

### Contributed Surplus

Our contributed surplus increased by \$52 to \$9,252 as at March 31, 2009 from \$9,200 as at December 31, 2008 primarily as a result of the stock option compensation expense recognized in the Consolidated Statement of Operations.

## **28.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 April 30, 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	7,606,907
<b>Issued / Exercised</b>	-	-	-
<b>Granted</b>	-	-	-
<b>Cancelled / Expired</b>	-	-	(613,132)
<b>Outstanding at April 30, 2009</b>	<b>55,993,929</b>	<b>9,300,000</b>	<b>6,993,775</b>

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

As at April 30, 2009, there were 9,300,000 common share purchase warrants outstanding at an exercise price of \$0.03 per share.

As at April 30, 2009 there were 6,993,775 stock options outstanding at exercise prices ranging from \$0.02 to \$0.68 with expiry dates from January 20, 2010 through June 28, 2012.

## **29. COMMITMENTS AND CONTINGENCIES**

Pursuant to the agreement of purchase and sale between Tecslut and the Company, under which we purchased the Eduplus assets from Tecslut 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 has received a demand letter from Tecslut's counsel demanding \$500 plus interest pursuant to these provisions of the teaming agreement. The Company is currently negotiating a settlement that will see future payments paid into escrow until the final settlement amount is paid in full. The Company anticipates that the settlement will be for less than the claimed amount and that 10% of each payment made by Sikorsky Aircraft Corporation into the escrow account will be paid to Tecslut, and the remainder to the Company.

## **30. 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 March 31, 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.

## **31. 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 during the first quarter of 2009 (2008 - \$25) 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 Company's board of directors effective March 19, 2009.

In addition, the Company recorded an expense of \$75 (2008 - nil), including related costs, for consulting services provided by CEO Capital Corporation. ("CEO Capital"), an organization of which a director of the Company is a principal shareholder. 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. 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 ended March 31, 2009.

On September 16, 2008, the Company's board of directors approved the reimbursement of \$90 of consulting fee expenditures to CEO Capital. This amount is to be paid in six equal monthly instalments commencing in October 2008 and is pursuant to the consulting agreement with CEO Capital. As at March 31, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in April 2009.

Also, the Company recorded an expense of \$10 (2008 - nil), including related costs, 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 March 31, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in April 2009.

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.

The amount due to related parties included in accounts payable and accrued liabilities as at March 31, 2009 was \$108 (2008 - \$178), and includes an amount of \$98 due to Gowlings.

## **32. SUBSEQUENT EVENTS**

On April 15, 2009, the Company received a partial payment of approximately \$1.3 million, net of applicable fees, under the OMDC refundable tax credit program.

Also see "Highlights and Summary – Recent Developments".

## **33. ACCOUNTING POLICY DEVELOPMENTS**

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.

### **Recently issued accounting 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.

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.

Due to the relatively short period between our filing of the Company’s MD&A for the year ended December 31, 2008 and this MD&A we have no further updates on the status of our transition to IFRS from those found in the Company’s annual MD&A for 2008.

#### **34. 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, 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.

#### **35. BUSINESS OUTLOOK**

The following contains forward-looking statements about our business outlook for 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, new customer orders and the receipt of the balance of applied for OMDC refundable tax credits of approximately \$165, net of applicable fees.

Assuming adequate liquidity, our performance in 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.

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 March 31, 2009, approximately \$1.7 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 and the outstanding ComVest Operating Line.
- 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, the receipt of refundable tax credits, 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. 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").
- With respect to the TSX delisting review, the Company has been notified by the TSX that its delisting review period has been extended to July 3, 2009. The Company has been working on remedying its continued listing deficiencies but there can be no assurances that it will be able to do so by this date. The Company is investigating alternatives if its common shares are delisted from the TSX.

## **36. 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 March 31, 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 March 31, 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).

May 14, 2009

*Interim Consolidated Financial Statements of*

**ATLANTIS SYSTEMS CORP.**

*March 31, 2009 and 2008*

# ATLANTIS SYSTEMS CORP.

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March 31, 2009 and 2008

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**ATLANTIS SYSTEMS CORP.****Consolidated Statements of Operations, Comprehensive Loss and Deficit****For the three months ended March 31, 2009 and 2008****(Expressed in thousands of Canadian dollars except per share amounts)****(unaudited)**

	<u>2009</u>	<u>2008</u>
Revenue (notes 5, 14 and 15)	\$ 3,934	\$ 4,339
Cost of revenue (note 5)	1,546	4,192
Gross margin	<u>2,388</u>	<u>147</u>
Expenses		
General and administrative	1,240	1,438
Selling and marketing	460	367
Stock options	53	36
	<u>1,753</u>	<u>1,841</u>
Operating income (loss) before the undernoted items	635	(1,694)
Depreciation and amortization	392	530
Interest and financing costs, net (note 8)	354	78
Net loss and comprehensive loss	<u>(111)</u>	<u>(2,302)</u>
Deficit, beginning of period	(102,380)	(78,963)
Deficit, end of period	<u>\$ (102,491)</u>	<u>\$ (81,265)</u>
Net loss per share (note 12)		
Basic and diluted	\$ -	\$ (0.04)
Weighted average number of shares		
Basic and diluted	55,993,929	55,993,929

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

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

	<u>2009</u> (unaudited)	<u>2008</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 89	\$ 1,100
Trade and other receivables (note 5)	2,873	575
Unbilled revenue (note 5)	2,834	1,571
Inventory	288	315
Prepaid expenses	292	302
	<b>6,376</b>	<b>3,863</b>
Capital assets, net		
Long-term prepaid expenses	1,006	1,120
Other long-term assets	81	81
Mortgage receivable (note 6)	77	77
Deferred development costs and core technology, net (note 7)	166	164
	<b>1,594</b>	<b>1,859</b>
	<b>2,924</b>	<b>3,301</b>
	<b>\$ 9,300</b>	<b>\$ 7,164</b>
<b>LIABILITIES</b>		
Current liabilities		
Operating line of credit (note 9)	\$ 5,019	\$ 3,258
Accounts payable and accrued liabilities	3,809	3,371
Accrued costs on percentage completion	413	409
Deferred revenue	1,317	1,219
Term debt (notes 9, 11, 13 and 14)	2,074	2,197
	<b>12,632</b>	<b>10,454</b>
<b>SHAREHOLDERS' (DEFICIENCY) EQUITY</b>		
Share capital and warrants (notes 10 and 11)	89,907	89,890
Contributed surplus	9,252	9,200
Deficit	(102,491)	(102,380)
	<b>(3,332)</b>	<b>(3,290)</b>
	<b>\$ 9,300</b>	<b>\$ 7,164</b>

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

**ATLANTIS SYSTEMS CORP.**  
**Consolidated Statements of Cash Flows**  
For the three months ended March 31, 2009 and 2008  
(Expressed in thousands of Canadian dollars)  
(unaudited)

	<u>2009</u>	<u>2008</u>
Cash flows provided by (used in) :		
<b>Operating activities :</b>		
Net loss	\$ (111)	\$ (2,302)
Items not affecting cash:		
Depreciation and amortization	392	530
Stock options expensed	53	36
Accretion on term debt	125	-
Financing costs related to re-pricing of common share purchase warrants	16	-
	<u>475</u>	<u>(1,736)</u>
Interest on mortgage receivable	(2)	(4)
Long-term prepaid expenses	-	(2)
Net change in non-cash working capital (note 16)	<u>(2,983)</u>	<u>(1,880)</u>
	<u>(2,510)</u>	<u>(3,622)</u>
<b>Investing activities :</b>		
Investment in capital assets	(14)	(20)
	<u>(14)</u>	<u>(20)</u>
<b>Financing activities :</b>		
Term debt repayment	-	-
Principal payment on term debt	(321)	(140)
	<u>(321)</u>	<u>(140)</u>
Net cash provided by foreign exchange loss on term debt	73	-
Net decrease in cash	<u>(2,772)</u>	<u>(3,782)</u>
	<u>(2,158)</u>	<u>3,720</u>
(Bank indebtedness, net) cash and cash equivalents, beginning of period		
(Bank indebtedness, net), end of period	<u>\$ (4,930)</u>	<u>\$ (62)</u>

**SUPPLEMENTAL INFORMATION**

(Bank indebtedness, net) is comprised of:

Cash	\$ 89	\$ 34
Bank operating line of credit	(5,019)	(96)
	<u>\$ (4,930)</u>	<u>\$ (62)</u>

Interest paid	\$ 211	\$ 48
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**

**March 31, 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). Atlantis Systems International Inc. (“ASI”) and Atlantis Systems America Inc. (“ASA”) are operating subsidiaries of the Company. ASI is a training integrator specializing in military, commercial aviation and energy markets worldwide. ASI combines desktop and full-flight simulation, knowledge management, learning management systems and multimedia courseware to provide integrated training systems to the customers. ASA has been established to provide similar services in the United States. In addition, the Company has an 85% interest in Denbridge Digital Limited, which is an inactive holding company.

### **2. 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 three months ended March 31, 2009 the Company incurred a net loss of \$111, and has a working capital deficiency of \$6,256, a deficit of \$102,491 and a shareholders’ deficiency of \$3,332 as at March 31, 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 has determined to defer its delisting decision until July 3, 2009. The Company will be permitted to make further submissions to the TSX regarding this matter on or before June 29, 2009. If the Company cannot satisfy the TSX that the deficiencies have been rectified, it may determine to delist the Company’s common shares. In such event, the TSX would issue written notice to the market as to the date the delisting would be effective, which would generally be 30 days after the written notice.

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 three months ended March 31, 2009 are not necessarily indicative of the results to be expected for any future periods.

# ATLANTIS SYSTEMS CORP.

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

March 31, 2009 and 2008

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

### 3. 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.

### 4. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### *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.

### 5. CONCENTRATION OF CREDIT RISK

The Company has contracts with many customers; however, as at March 31, 2009, two customers each represented 55% and 16% of the trade receivables and unbilled revenue (March 31, 2008 - 22% and 44%). Two different customers represented 31% and 12% (2008 - 41% and 8%) while the first customer represented 29% of revenue for the three months ended March 31, 2009 (2008 - 13%)

The following table summarizes the value of assets included in trade and other receivables:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Trade receivables	\$ 1,350	\$ 575
Other receivables	1,523	-
	<u>\$ 2,873</u>	<u>\$ 575</u>

In the first quarter of 2009, the Company accrued a receivable of \$1,451 for refundable tax credits under a Government of Ontario refundable tax credit program and recorded, net of applicable fees, a reduction of \$1,306 in cost of revenue. The recognition of the receivable was based on the amount approved for initial payment pursuant to an audit on the Government of Ontario’s behalf. The receivable, paid on April 15, 2009, represents approximately 90% of the amount originally estimated by the Government of Ontario. After further auditor review of the eligibility of certain overhead costs, the Company was informed in May 2009, that the balance has been approved for payment.

# ATLANTIS SYSTEMS CORP.

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

March 31, 2009 and 2008

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

### 6. MORTGAGE RECEIVABLE

The mortgage receivable earns interest monthly at 4.5% per annum. The final principal payment of \$200 is due on December 1, 2013 and has been discounted at a rate of 9%. The Company is currently in arrears and should it default on the payment of the premises rent, the mortgage receivable will be null and void.

### 7. DEFERRED DEVELOPMENT COSTS AND CORE TECHNOLOGY

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

	March 31, 2009			
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Impairment Loss</u>	<u>Net Book Value</u>
Eduplus core technology	3,188	1,594	-	1,594
	<u>\$ 4,927</u>	<u>\$ 2,246</u>	<u>\$ 1,087</u>	<u>\$ 1,594</u>

  

	December 31, 2008			
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Impairment Loss</u>	<u>Net Book Value</u>
HVTT deferred development costs	\$ 1,739	\$ 652	\$ 1,087	\$ -
Eduplus core technology	3,188	1,329	-	1,859
	<u>\$ 4,927</u>	<u>\$ 1,981</u>	<u>\$ 1,087</u>	<u>\$ 1,859</u>

The Company had funded a specific development project focused on the Helicopter Virtual Task Trainer (“HVTT”) concept. As management is no longer reasonably certain of the level, if any, of future sales of a HVTT based product, the remaining net book value of \$1,087 was written off in 2008.

Eduplus core technology is software that was acquired in the purchase of the Eduplus division of Tecsalt Inc. (“Tecsult”) on September 27, 2007, and is being amortized over three years. Amortization for the three months ended March 31, 2009 was \$265 (2008 - \$266).

### 8. INTEREST AND FINANCING COSTS, NET

Interest and financing costs, net for the three months ended March 31, 2009 and 2008 are as follows:

# ATLANTIS SYSTEMS CORP.

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

March 31, 2009 and 2008

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

### 8. INTEREST AND FINANCING COSTS, NET (continued)

	2009	2008
Interest expense	\$ 336	\$ 48
Finance and bank charges <sup>(1)</sup>	43	51
Interest income <sup>(2)</sup>	(25)	(21)
	<u>\$ 354</u>	<u>\$ 78</u>

<sup>(1)</sup> Includes \$16 in 2009 for the expense related to re-pricing warrants granted to ComVest Capital LLC (“ComVest”) in lieu of a covenant-waiver fee (note 9).

<sup>(2)</sup> Includes \$21 in 2009 for the accrued interest on refundable tax credits (note 5).

### 9. 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”).

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 March 31, 2009, and December 31, 2008. In addition, as at March 31, 2009, and December 31, 2008, the Company had exceeded its maximum borrowing limit for the revolving Line of Credit by US\$1,398 and US\$2,469, respectively. 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 in lieu of covenant waiver fees that would have been otherwise charged by ComVest for these periods.(note 11). The expense of \$16 related to re-pricing the warrants is included in interest expense and financing costs. ComVest had previously provided waivers without charge for the breach of the same Term Loan covenant at September 30, 2008 and June 30, 2008 and for the Company exceeding its maximum borrowing limit for the revolving Line of Credit on September 30, 2008 (note 11).

The Company has been advised by ComVest that effective April 1, 2009, ComVest will begin 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

# ATLANTIS SYSTEMS CORP.

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

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### 9. OPERATING LINE OF CREDIT, TERM LOANS AND CASH (continued)

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 been changed.

The Term debt liability includes the following as at March 31, 2009:

Loan proceeds from Comvest	US\$	2,600
Financing costs		(380)
Common share warrants expense		(572)
Accretion of financing costs		344
Principal payments		(347)
Term debt liability in US currency	US\$	1,645
Canadian exchange on loan proceeds		429
Term debt liability in Canadian currency	\$	2,074

The Company has utilized \$5,019 (US\$3,979) of the Line of Credit as of March 31, 2009 (December 31, 2008 – \$3,258).

The Company anticipates it will violate covenant requirements at future compliance dates; therefore the entire balance of the Term Loan has been classified as a current liability.

### 10. SHARE CAPITAL

In the three months ended March 31, 2009, the Company expensed \$53 (2008 - \$36), 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.

In the three months ended March 31, 2009, no common share stock options were exercised, while there were 559,799 common share stock options that either expired or were cancelled. As at March 31, 2009, the Company had 7,047,108 common share options outstanding.

As at March 31, 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 9 and 11). The Company received TSX approval for the re-pricing on April 9, 2009. In addition, in the three months ended March 31, 2009, no common share warrants were exercised and no common share warrants expired.

# **ATLANTIS SYSTEMS CORP.**

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

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### **11. 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 and while remaining in compliance with existing or future debt covenants. The Company's current situation requires an approach to managing our capital that will not generally focus on optimizing the cost of such capital and will most likely in the short-term favor debt financing.

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 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 March 31, 2009, December 31, 2008 and September 30, 2008, the Company had exceeded its maximum borrowing limit for the revolving Line of Credit. 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. The Company received TSX approval for the re-pricing on April 9, 2009. This warrant re-pricing is 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. 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 March 31, 2009 and December 31, 2008 are as follows:

# ATLANTIS SYSTEMS CORP.

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

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### 11. MANAGING CAPITAL (continued)

	2009	2008
Interest bearing debt	\$ 7,093	\$ 5,455
Shareholders' deficit	(3,332)	(3,290)
<b>Total capital</b>	<b>\$ 3,761</b>	<b>\$ 2,165</b>

### 12. NET (LOSS) INCOME PER SHARE

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

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

The weighted average number of shares outstanding used in the calculation of basic earnings per share for the three months ended March 31, 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 months ended March 31, 2009 and 2008 were as follows:

	2009	2008
Weighted average common shares outstanding	55,993,929	55,993,929
Weighted average potential common shares		
Share purchase warrants	-	-
Stock options	-	-
	<b>55,993,929</b>	<b>55,993,929</b>

For the three months ended March 31, 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.

### 13. 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.

# ATLANTIS SYSTEMS CORP.

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

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### 13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

#### *Financial assets recorded at amortized cost*

Trade and other receivables, unbilled revenue, and the mortgage receivable 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 March 31, 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 March 31, 2009.

### 14. 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 March 31, 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.

# ATLANTIS SYSTEMS CORP.

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

March 31, 2009 and 2008

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

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### 14. FINANCIAL RISK MANAGEMENT (continued)

#### *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. Management expects that such customers, as well as public and private organizations within the power generation sector, will provide a greater contribution to the Company's revenue in 2009. 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 credits (note 5). Subsequently, the Company was notified that the balance of \$167, net of applicable fees, had been approved for payment.

The Company as of March 31, 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. 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 on reasonable terms in the current marketplace; and the ability to significantly increase its backlog through new contracts being awarded to the Company (notes 2, 9 and 19). In April 2009, the Company was notified by ComVest that effective April 1, 2009, ComVest will begin charging an additional default interest of 5% per annum on the Term Debt and the Line of Credit (note 9).

The following are the contractual maturities of financial liabilities, including interest payments, as at March 31, 2009.

# ATLANTIS SYSTEMS CORP.

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

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### 14. FINANCIAL RISK MANAGEMENT (continued)

	Carrying amount	Contractual cash flows	3 months or less	3-12 months	1 - 2 years	2 - 3 years
<u>ComVest interest rates - not in default</u>						
Accounts payable and accrued liabilities (1)	\$ 3,809	\$ (3,809)	\$ (3,259)	\$ (534)	\$ (16)	\$ -
Operating line of credit (2)(3)(5)	5,019	(5,856)	(100)	(301)	(402)	(5,053)
Term debt (3)(4)(5)	2,074	(3,503)	(410)	(1,167)	(1,413)	(513)
	<u>\$ 10,902</u>	<u>\$ (13,168)</u>	<u>\$ (3,769)</u>	<u>\$ (2,002)</u>	<u>\$ (1,831)</u>	<u>\$ (5,566)</u>

#### ComVest interest rates - in default

Accounts payable and accrued liabilities (1)	\$ 3,809	\$ (3,809)	\$ (3,259)	\$ (534)	\$ (16)	\$ -
Operating line of credit (3)(6)	5,019	(6,378)	(163)	(489)	(652)	(5,073)
Term debt (3)(7)	2,074	(3,654)	(443)	(1,242)	(1,455)	(514)
	<u>\$ 10,902</u>	<u>\$ (13,841)</u>	<u>\$ (3,865)</u>	<u>\$ (2,265)</u>	<u>\$ (2,123)</u>	<u>\$ (5,587)</u>

(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 March 31, 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 March 31, 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.

# ATLANTIS SYSTEMS CORP.

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

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### 14. FINANCIAL RISK MANAGEMENT (continued)

#### (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. ComVest has notified the Company that effective April 1, 2009 the floor rate will increase to 13% per annum for periods the Company is in default (note 9). The US Federal Reserve Board continuously lowered its prime lending rate throughout 2008 in response to the current global financial crisis and at March 31, 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. Effective April 1, 2009, ComVest will charge an additional 5% per annum for default interest. The Company therefore will have monthly cash interest payments on the Term Debt of approximately \$27.1, when not in default, and \$37.9, 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.

##### *Quantification of foreign currency risk*

At March 31, 2009, the Company's gross balance sheet exposure to foreign currency risk was substantially as follows:

# ATLANTIS SYSTEMS CORP.

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

March 31, 2009 and 2008

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### 14. FINANCIAL RISK MANAGEMENT (continued)

<i>In Canadian \$ equivalents (000's)</i>	Canadian	US	Other	Total
Cash	\$ 27	\$ 62	\$ -	\$ 89
Trade and oither receivables	2,502	371	-	2,873
Operating line of credit	-	(5,019)	-	(5,019)
Accounts payable and accrued liabilities	(3,402)	(400)	(7)	(3,809)
Term debt	-	(2,074)	-	(2,074)
Net balance sheet exposure	\$ (873)	\$ (7,060)	\$ (7)	\$ (7,940)

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 ended March 31, 2009 and 2008 were substantially as follows:

<i>In Canadian \$ equivalents (000's)</i>	2009			2008		
	Canadian	US	Total	Canadian	US	Total
Revenue	\$ 1,713	\$ 2,221	\$ 3,934	\$ 2,145	\$ 2,194	\$ 4,339
Cost of revenue and operating expenses	\$ 2,026	\$ 1,273	\$ 3,299	\$ 4,032	\$ 2,001	\$ 6,033
Interest and financing costs (income)	\$ (22)	\$ 376	\$ 354	\$ 78	\$ -	\$ 78

#### *Fair value sensitivity analysis*

*Gross Balance Sheet Exposure:* A 10% strengthening of the Canadian dollar against the US dollar at March 31, 2009 would have decreased the net loss by approximately \$705. This analysis assumes that all other variables, in particular interest rates, remain constant and represents the Company's gross balance sheet exposure at March 31, 2009. A 10% weakening of the Canadian dollar against the same would have had an equal but opposite effect.

*Net Revenue Exposure:* A 10% strengthening on average of the Canadian dollar against the US dollar for the three months ended March 31, 2009 would have decreased net revenue by approximately \$220. 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.

*Expense Exposure:* A 10% strengthening on average of the Canadian dollar against the US dollar in the above table for the three months ended March 31, 2009 would have decreased cost of goods sold, operating expenses and interest expense, in total, by approximately \$165. 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

# ATLANTIS SYSTEMS CORP.

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### 14. FINANCIAL RISK MANAGEMENT (continued)

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.

### 15. SEGMENTED INFORMATION

	Three months ended March 31, 2009			Three months ended March 31, 2008		
	Canada	USA	Total	Canada	USA	Total
Revenue from external customers	\$ 3,462	\$ 472	\$ 3,934	\$ 3,980	\$ 359	\$ 4,339
Inter-segment revenues	\$ -	\$ 81	\$ 81	\$ -	\$ 592	\$ 592
Interest revenue	\$ 25	\$ -	\$ 25	\$ 21	\$ -	\$ 21
Interest expense	\$ 336	\$ -	\$ 336	\$ 48	\$ -	\$ 48
Amortization of capital assets	\$ 91	\$ 36	\$ 127	\$ 106	\$ 49	\$ 155
Amortization of deferred costs	\$ 265	\$ -	\$ 265	\$ 375	\$ -	\$ 375
Segment profit (loss)	\$ 643	\$ (754)	\$ (111)	\$ (1,328)	\$ (974)	\$ (2,302)
Segment assets at end of period	\$ 8,936	\$ 364	\$ 9,300	\$ 25,415	\$ 599	\$ 26,014
Expenditures for segment capital assets	\$ 14	\$ -	\$ 14	\$ 19	\$ 1	\$ 20

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.

	Revenue		Capital Assets, Intangibles and Goodwill	
	Three months ended		March 31,	
	March 31,		March 31,	
	2009	2008	2009	2008
Canada	\$ 1,713	\$ 2,145	\$ 2,494	\$ 17,020
International	2,221	2,194	106	261
	\$ 3,934	\$ 4,339	\$ 2,600	\$ 17,281

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

# ATLANTIS SYSTEMS CORP.

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### 16. NET CHANGE IN NON-CASH WORKING CAPITAL

Net change in non-cash working capital of continuing operations for the three months ended March 31, 2009 and 2008:

	2009	2008
Trade receivables and other receivables	\$ (2,298)	\$ (2,378)
Unbilled revenue	(1,263)	(459)
Inventory	27	(23)
Prepaid Expenses	10	526
Accounts payable and accrued liabilities	439	(668)
Accrued costs on percentage completion	4	153
Deferred revenue	98	969
	<u>\$ (2,983)</u>	<u>\$ (1,880)</u>

### 17. 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 ended March 31, 2009, the Company incurred expenses of \$177 (2008 - \$203) 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. The amount due to related parties included in accounts payable and accrued liabilities as at March 31, 2009 was \$108 (December 31, 2008 - \$115). This amount at March 31, 2009 includes an amount of \$98 due to the law firm Gowling Henderson Lafleur LLP of which a former director was a partner. The director resigned from the Company's board of directors effective March 19, 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 calls for a fee of \$25 per month. As at March 31, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in April, 2009.

Also, 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. As at March 31, 2009, pursuant to the terms of the consulting agreement, the Company had prepaid the fee for services provided in April, 2009.

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.

# **ATLANTIS SYSTEMS CORP.**

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

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### **18. SUBSEQUENT EVENTS**

In April 2009, the Company received a partial payment of \$1,306, net of applicable fees, from the Ontario Media Development Corporation refundable tax credit program (note 5).

In April 2009, the Company was awarded a contract for \$2,002 by L-3 Communications MAPPS Inc. 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.

In April 2009 the Company was notified that the TSX has determined to defer its delisting decision until July 3, 2009 (note 2).

In April 2009, ComVest informed the Company that effective April 1, 2009, they will begin charging additional default interest of 5% per annum on the Term Debt and Line of Credit (note 9).