Interim Condensed Consolidated Financial Statements
July 31, 2011
(Unaudited)

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Financial Position
Unaudited
(thousands of Canadian dollars)

	Note	July 31, 2011	January 31, 2011
Assets			
Current assets:			
Cash		$ 2,144	$ 7,399
Restricted cash		634	834
Trade and other receivables		51,886	16,895
Income taxes recoverable			
Inventory		17,264	14,884
Prepaid expenses and other		4,971	2,159
		76,899	42,171
Property and equipment		150,069	149,213
Goodwill		37,862	37,862
Intangible assets		16,939	19,159
Investments in equity accounted investees		3,007	2,533
		$ 284,776	$ 250,938
Liabilities and Shareholders' Equity			
Current liabilities:			
Bank indebtedness	5	$ 11,611	$ -
Trade and other payables		23,086	12,418
Income taxes payable		3,726	1,244
Current portion of finance leases	4	23	54
Current portion of loans and borrowings	3	9,728	38,786
		48,174	52,502
Finance leases	4	3,228	118
Loans and borrowings	3	111,476	100,322
Deferred income taxes		25,105	22,927
		139,809	123,367
Shareholders' equity:	6		
Share capital		69,585	65,134
Contributed surplus		9,050	7,170
Retained earnings		18,158	2,765
		96,793	75,069
		$ 284,776	$ 250,938

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Earnings and Comprehensive Earnings

Unaudited

(thousands of Canadian dollars, except per share amounts)

		For the three months ended		For the six months ended	
	Note	**July 31, 2011**	**July 31, 2010**	**July 31, 2011**	**July 31, 2010**
Revenue		$ 70,657	$ 57,658	$ 107,906	$ 83,473
Expenses		41,208	31,803	73,668	55,259
Depreciation of property and equipment and intangible assets		6,184	5,973	10,688	10,355
		23,265	19,882	23,550	17,859
Finance costs		4,719	4,306	8,470	7,851
Gain on extinguishment of related party debt	3	(5,900)	-	(5,900)	-
Gain on sale of property and equipment		(369)	(263)	(115)	(262)
Share of earnings of equity accounted investees (net of income tax)		(245)	(268)	(474)	(344)
		(1,795)	3,775	1,981	7,245
Earnings before income taxes		25,060	16,107	21,569	10,614
Income tax provision (recovery)					
Current		3,678	4,963	4,241	3,398
Deferred		3,403	(180)	1,935	(181)
		7,081	4,783	6,176	3,217
Earnings and comprehensive earnings		$ 17,979	$ 11,324	$ 15,393	$ 7,397
Earnings per share:					
Basic earnings per share	7	$ 0.12	$ 0.08	$ 0.11	$ 0.05
Diluted earnings per share	7	$ 0.10	$ 0.08	$ 0.10	$ 0.05

See accompanying notes to the interim condensed consolidated financial statements

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Shareholders' Equity

Unaudited

(thousands of Canadian dollars)

	Note	Share Capital	Contributed surplus	Retained earnings (deficit)	Total equity
Balance at February 1, 2010		$ 184,535	$ 7,141	$ (121,821)	$ 69,855
Reclassification of deficit		(119,401)	-	119,401	-
Net earnings		-	-	7,397	7,397
Share-based compensation	6	-	5	-	5
Balance at July 31, 2010		$ 65,134	$ 7,146	$ 4,977	$ 77,257
Balance at February 1, 2011		$ 65,134	$ 7,170	$ 2,765	$ 75,069
Net earnings		-	-	15,393	15,393
Shares issued on debt extinguishment		4,451	-	-	4,451
Fair value of conversion feature on convertible debenture	3	-	1,843	-	1,843
Share-based compensation	6	-	37	-	37
Balance at July 31, 2011		$ 69,585	$ 9,050	$ 18,158	$ 96,793

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Interim Condensed Consolidated Statements of Cash Flows

Unaudited

(thousands of Canadian dollars)

	Note	For the six months ended **July 31 2011**	**July 31 2010**
Cash provided by (used in):			
Operating activities:			
Earnings		$ 15,393	$ 7,397
Adjustments for:			
Current tax expense		4,241	3,398
Deferred tax expense (recovery)		1,935	(181)
Finance costs		8,470	7,851
Share-based compensation	6	37	5
Deferred share unit compensation	6	304	120
Depreciation of property and equipment and intangible assets		10,688	10,355
Share of earnings of equity accounted investees		(474)	(344)
Gain on disposal of property and equipment		(115)	(262)
Gain on extinguishment of related party debt		(5,900)	-
		34,579	28,339
Change in non-cash operating working capital	8	(29,849)	(26,078)
Interest paid		(6,842)	(6,894)
Income taxes paid		(1,516)	(2,935)
Income taxes received		-	295
Net cash used in operating activities		(3,628)	(7,273)
Investing activities:			
Acquisition of property and equipment		(9,013)	(7,316)
Proceeds on disposal of property and equipment		2,474	2,638
Net cash used in investing activities		(6,539)	(4,678)
Financing activities:			
Proceeds from operating line of credit		11,611	12,115
Loans and borrowings transaction costs		(2,227)	-
Proceeds from loans and borrowings		34,500	-
Repayment of loans, borrowings and finance leases		(38,972)	(4,857)
Net cash from financing activities		4,912	7,258
Decrease in cash		(5,255)	(4,693)
Cash, beginning of period		7,399	7,355
Cash, end of period		$ 2,144	$ 2,662

See accompanying notes to the interim condensed consolidated financial statements.

DISCOVERY AIR INC.

Notes to the interim condensed consolidated financial statements (unaudited)
For the six months ended July 31, 2011 and 2010

1. Reporting entity

Discovery Air Inc. (the "Corporation") was incorporated on November 12, 2004 under the *Ontario Business Corporations Act* and on March 27, 2006 was continued under the *Canada Business Corporations Act*. The address of the head office is P.O Box 1530, 126 Bristol Avenue, Yellowknife, NT, X1A 2P2, Canada. The Corporation's primary business activities are to provide aviation and aviation-related services through its wholly-owned subsidiaries Great Slave Helicopters Ltd. ("Great Slave"), Air Tindi Ltd. ("Air Tindi"), Top Aces Inc. ("Top Aces"), Hicks & Lawrence Limited ("Hicks"), Discovery Mining Services Ltd. ("Discovery Mining"), Discovery Air Technical Services Inc. ("Technical Services"), and Discovery Air Innovations Inc. ("Innovations"). Certain of these wholly-owned subsidiaries also conduct a portion of their business activities through jointly controlled or non-controlled entities. The Corporation's common stock is traded on the Toronto Stock Exchange under the symbol "DA.A".

Great Slave is a helicopter company that, directly and in partnership with northern Aboriginal groups, operates a fleet of 68 helicopters and provides services throughout northern Canada, in several Canadian provinces and in a number of international locations. Services are provided to private sector companies and governments in areas such as resource and base mineral exploration and production, wildlife services, forest fire suppression, oil and gas exploration, power line construction and maintenance, aerial surveys, tourism and flight training. Great Slave's principal operations are carried out in Yellowknife, Northwest Territories and Calgary, Alberta. Great Slave has additional facilities in Fort Simpson, Fort Liard, Norman Wells and Inuvik in the Northwest Territories, Rankin Inlet in Nunavut, Churchill in Manitoba and Dryden in Ontario.

Air Tindi, based in Yellowknife, operates a diversified fleet of 21 fixed-wing aircraft offering scheduled and chartered passenger and cargo services, as well as air ambulance services, in northern Canada. Air Tindi, both directly and in partnership with northern Aboriginal groups, provides services to a diversified customer base that includes major diamond and mineral exploration and mining companies, as well as the Governments of Canada and the Northwest Territories.

Discovery Mining is a provider of remote exploration camps and expediting, logistics and staking services to diamond and mineral exploration companies. Based in Yellowknife, Discovery Mining conducts operations in the Northwest Territories, Nunavut, northern Alberta, northern Saskatchewan and northern Ontario.

Top Aces is a Quebec-based approved supplier of airborne training and special mission services to the Department of National Defence ("DND"). Top Aces operates a fleet of 21 aircraft. Top Aces provides a variety of military training services ranging from simulated combat to target tow and ground support, operating throughout Canada as well as in parts of the United States.

Hicks is an Ontario-based aviation company that provides aerial fire management services to the Province of Ontario, employing 29 aircraft from bases throughout northern Ontario. Hicks also provides air charter services, using 3 aircraft, to the provincial government and various other corporate entities which conduct business in northern Ontario.

Technical Services is a Quebec-based company that provides a range of aircraft maintenance, repair and overhaul, modification engineering and certification services.

Innovations is a Quebec-based company which acts as the Corporation's business development arm focused on identifying and capturing new market opportunities.

The Corporation's businesses are, to varying degrees, seasonal in nature. Seasonality and other factors such as weather conditions can affect the comparability of results from one period to another, particularly from quarter to quarter.

Some of the seasonal factors that impact quarterly results are as follows: there is increased demand for the services provided by Great Slave, Hicks, Air Tindi and Discovery Mining normally commencing in the late spring and continuing through to the end of the summer; Top Aces' revenue-generating opportunities are significantly higher in the February to June and September to November time periods; though Top Aces' revenues are relatively predictable over a twelve month period, they can vary substantially from month to month depending on weather conditions and its customers' priorities; weather conditions can have an impact on flight activity from one period to another, especially in the Corporation's fire suppression activities; the Corporation attempts to perform most major repairs and refurbishment during the slower periods of revenue-generating potential; and repair and maintenance on aircraft do not occur evenly throughout the year and the timing of related expenses within a year may vary from one period to another.

2. Basis of preparation

(a) Statement of compliance

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as issued by the International Financial Reporting Standards Board ("IASB"). These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The accounting policies and basis of preparation differ from those set out in the previously published consolidated financial statements for the year ended January 31, 2011, which were prepared in accordance with Canadian Generally Accepted Accounting Principles ("CGAAP"). The interim condensed consolidated financial statements do not include all of the information required for full annual financial statement disclosure and should be read in conjunction with the Corporation's consolidated financial statements for the year ended January 31, 2011 and the Corporation's first interim condensed consolidated financial statements reported under IFRS for the three months ended April 30, 2011 and 2010. An explanation of how the transition from CGAAP to IFRS has affected the reported financial position, financial performance and cash flows of the Corporation as at and for the three and six months ended July 31, 2010 is set out in notes 11 and 12. These notes include reconciliations of equity and total comprehensive income from CGAAP to IFRS for the comparative period. There have been no changes to the Corporation's accounting policies from those disclosed in the interim condensed consolidated financial statements for the three months ended April 30, 2011 and 2010.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of the Corporation ("the Board") on September 9, 2011.

(b) Basis of measurement

The interim condensed consolidated financial statements have been prepared on the historical cost basis except for liabilities for cash-settled share-based payment arrangements, which are measured at fair value.

(c) Functional and presentation currency

These interim condensed consolidated financial statements are presented in Canadian dollars, which is the functional currency of the Corporation and its subsidiaries. All financial information presented in Canadian dollars has been rounded to the nearer thousand dollars except for share and per share amounts.

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the date of the interim condensed consolidated statement of financial position and non-monetary items that are measured in terms of historical cost are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in finance costs.

(d) Use of estimates and judgements

The preparation of the interim condensed consolidated financial statements in conformity with IFRS requires management to make estimates, judgements and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses, and disclosures of contingent assets and liabilities at the dates of the interim condensed consolidated financial statements. Actual results may differ materially from these estimates.

Estimates, judgements and assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to estimates, judgements and assumptions are recognized in the period in which the estimates, judgements and assumptions are revised and in any future periods affected.

Significant estimates, judgements and assumptions used in the preparation of these interim condensed consolidated financial statements include estimates, judgements and assumptions used in the determination of the allowance for doubtful accounts and of the useful lives of property and equipment and intangible assets with finite useful lives.

(e) Future accounting standards

A number of new standards and amendments to standards and interpretations are not yet effective for the quarter ended July 31, 2011 and have not been applied in preparing these interim condensed consolidated financial statements. The following standards and interpretations have been issued by the IASB and the International Financial Reporting Interpretations Committees:

(i) IFRS 9 Financial Instruments, issued in November 2009, is the first step in the process to replace IAS 39 Financial Instruments: Recognition and Measurement; IFRS 9 Financial Instruments introduces new requirements for classifying and measuring financial assets; the standard of IFRS 9 Financial Instruments is not applicable until years beginning on or after January 1, 2013, but is available for early adoption; the Corporation has not early adopted IFRS 9 Financial Instruments, and is yet to assess its full impact;

(ii) in May 2011, the IASB issued IFRS 10 Consolidated Financial Statements which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted; the Corporation intends to adopt IFRS 10 in its financial statements for the annual period beginning on February 1, 2013; the Corporation has not yet determined the impact of adoption of IFRS 10;

(iii) in May 2011, the IASB issued IFRS 11 Joint Arrangements which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted; upon application of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation will collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented; the investment's opening balance is tested for impairment in accordance with IAS 28 (2011) and IAS 36 Impairment of Assets; any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented; the Corporation intends to adopt IFRS 11 in its financial statements for the annual period beginning on February 1, 2013; the Corporation does not expect IFRS 11 to have a material impact on its financial statements;

(iv) In May 2011, the IASB issued IFRS 12 Disclosure of Interests in Other Entities, which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. IFRS 12 contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and/or unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. The required disclosures aim to provide information in order to enable users to evaluate the nature of, and the risks associated with, an entity's interest in other entities, and the effects of those interests on the entity's financial position, financial performance and cash flows. The Corporation intends to adopt IFRS 12 in its financial statements for the annual period beginning on February 1, 2013. When applied, it is expected that the amendment to IFRS 12 will increase the current level of disclosure of interests in other entities.

(v) in May 2011, the IASB published IFRS 13 Fair Value Measurement which is effective prospectively for annual periods beginning on or after January 1, 2013; IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance; it defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price; the standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs, the effect of the measurements on earnings or loss or other comprehensive income; the Corporation intends to adopt IFRS 13 prospectively in its financial statements for the annual period beginning on February 1, 2013; the extent of the impact of adoption of IFRS 13 has not yet been determined;

(vi) in May 2011, the IASB issued Amendments to IAS 28 Investments in Associates and Joint Ventures which is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted; previously, IAS 28 (2008) and IAS 31 specified that the cessation of significant influence or joint control triggered remeasurement of any retained stake in all cases with gain recognition in earnings or loss, even if significant influence was succeeded by joint control; IAS 28 (2011) now requires that in such scenarios the retained interest in the investment is not remeasured; the Corporation intends to adopt the amendments in its financial statements for the annual period beginning on February 1, 2013; the extent of the impact of adoption of the amendments has not yet been determined; and

(vii) IAS 1 Presentation of Financial Statements – Presentation of items of Other Comprehensive Income ("OCI"); on June 16, 2011 the International Accounting Standards Board (IASB) issued amendments to IAS 1, which will require entities to present separately items of OCI that may be reclassified to profit or loss in the future from items that would never be reclassified to profit or loss; consequently, those entities that present items of OCI before related tax effects will have to allocate the aggregated tax amount between these categories; the amendments are effective for annual periods beginning on or after July 1, 2012 and are to be applied retrospectively; early adoption is permitted; the extent of the impact of adoption of the amendments has not yet been determined.

3. Loans and borrowings:

(in thousands of Canadian dollars)	July 31, 2011	January 31, 2011
8.375% unsecured convertible debentures, maturing June 30, 2016 (see below)	$ 30,564	$ -
8.75% unsecured convertible debentures, maturing December 31, 2011 (see below)	-	28,053
Long-term secured debt bearing a floating interest rate of 90 day BA yield plus 7.65%, maturing September 24, 2020	41,437	46,186
Long-term secured debt bearing a fixed interest rate of 10.00%, maturing February 1,	33,543	33,388
Long-term secured debt incurred by a subsidiary bearing an interest rate of floating base bank rate plus 5.0%, maturing January 15, 2015	10,630	12,149
Long-term secured debt incurred by subsidiary companies bearing fixed interest rates at an interest rate of 9.05%, maturing August 23, 2011	8	155
Long-term secured debt incurred by subsidiary companies bearing floating interest rates at a weighted average of 5.56%, maturing fiscal 2013 through fiscal 2021	1,789	1,897
Secured subordinated notes payable to officers and directors of the Corporation and its subsidiaries bearing interest at prime plus 1.25%, maturing fiscal 2015 through fiscal 2016 (see below)	-	13,447
Secured demand loan bearing an interest rate of 18.00% per annum, maturing August 26, 2011 (note 14)	3,233	3,833
Loans and borrowings	121,204	139,108
Less current portion of loans and borrowings	9,728	38,786
	$ 111,476	$ 100,322

On May 2, 2011, the Corporation completed a transaction to repay related party debts and accrued interest totalling $13.4 million through a cash payment of $3.1 million and the issuance of 10,352,000 Class A common shares. Based on the market value of the Class A common shares at the date of settlement ($0.43 per share), the Corporation recorded a pre-tax gain on the extinguishment of the related party debts of approximately $5.9 million in the current quarter. Interest expense on this debt for the quarter ended July 31, 2011 was $2,000 (July 31, 2010 - $81,000) and $145,000 (July 31, 2010 - $165,000) year-to-date.

On May 12, 2011, the Corporation closed a $30.0 million issuance of new 8.375% convertible unsecured subordinated debentures (the “New Debentures”) at a price of $1,000 per debenture. On May 27, 2011, the Corporation also closed the issuance of an overallotment option on the original issue of New Debentures, for an additional $4.5 million aggregate principal amount of New Debentures. The New Debentures mature on June 30, 2016 and will accrue interest at the rate of 8.375% per annum payable semi-annually. At the holders’ option, the New Debentures may be converted into the Corporation’s Class A common voting shares or Class B variable voting shares at any time prior to the maturity date of the New Debentures at a conversion price of $0.73 for each common share, subject to standard anti-dilution provisions. The New Debentures will not be redeemable before June 30, 2014. From June 30, 2014 to the maturity date, the Corporation may, at its option and subject to notice period requirements, redeem the New Debentures, in whole or in part, at par plus accrued and unpaid interest, provided that the weighted average trading price of the Corporation’s common shares on the Toronto Stock Exchange during a specified period prior to redemption is not less than 125% of the conversion price. The fair value of the New Debentures to make future payments of principal and interest was $32.7 million (the “liability component”) and the fair value of the holders’ conversion option was determined to be $1.8 million (the “equity component”). Transaction costs of $2.2 million were incurred related to the New Debentures and have been allocated between the liability and equity components in proportion to the allocation of the proceeds. The liability component is being accreted to the New Debentures’ face value of $34.5 million, calculated based on the effective interest rate of 11.61%.

On June 16, 2011, the Corporation used the net proceeds of issuance of the New Debentures to fully repay the Corporation’s $28.8 million 8.75% Convertible Unsecured Subordinated Debentures due December 31, 2011 and accrued interest payable thereon. The Corporation intends to use the remaining funds from the issuance of the New Debentures to fund working capital and for general corporate purposes.

On July 21, 2011, the Corporation entered into an agreement to complete a private placement of $70.0 million secured convertible debentures. These debentures would have a 5 ½ year term from issuance, subject to earlier redemption rights in favour of the Corporation relating to the achievement of certain milestone events by the Corporation. The Corporation may also redeem the debentures three years after issuance providing the Corporation’s common share weighted average trading price exceeds 116% of the then-applicable conversion price over a specified trading period prior to issuance of the redemption notice. Interest on the Debentures will accrue at a rate of 10% per annum and will be payable annually commencing 12 months after closing on an "in kind" basis through the issuance of additional Debentures. The original conversion price of the Debentures, $0.75 per common share, will also increase at 10% per annum, and as a result, the original face amount of the Debentures plus all paid-in-kind interest will continue to be convertible into 93,333,333 common shares (subject to customary anti-dilution adjustments). The Debentures will have a first-lien security interest in all assets of the Corporation except with respect to accounts receivable and certain inventory, and except with respect to certain assets already pledged to existing senior lenders to the Corporation. The Corporation will have the right to require full subordination of the Debentures' security interest in respect of new indebtedness upon the achievement of agreed milestone events by the Corporation. Prior to any of the milestone events being achieved, the Corporation can require subordination of the Debentures' security interest in yet-to-be acquired assets in an amount up to $50 million. The transaction is expected to be completed in September 2011 and net proceeds of the transaction will be used to repay existing debt owed to certain of the Corporation’s lenders.

Principal repayments on or in respect of the above-listed loans and borrowings as at July 31, 2011 for each of the next five years and thereafter are as follows:

(thousands of dollars)		
Within 1 year	$	9,728
Within 2 years		40,071
Within 3 years		6,891
Within 4 years		5,624
Within 5 years		35,005
Thereafter		23,885
Total	$	121,204

Interest on or in respect of the above–listed loans and borrowings for the three months and year-to-date totalled $3.7 million (July 31, 2010 - $3.6 million) and $6.9 million respectively (July 31, 2010 – $6.8 million). As at July 31, 2011, the Corporation was in compliance with all covenants related to the above listed-loans and borrowings.

4. Finance leases:

The Corporation has leases of various facilities, equipment and vehicles which are classified as finance leases. The interest rates underlying these leases range from 6.5% to 10.93% per annum and lease terms ranging from 1 year to 23 years. The obligations under these leases are secured by the related assets associated with the leases.

Finance leases liabilities are payable as follows:

(thousands of Canadian dollars)

Minimum lease payment due	Within one year	One to five years	After five years	Total
July 31, 2011:				
Future minimum lease payments	$ 258	$ 1,460	$ 5,192	$ 6,910
Interest	(235)	(912)	(2,512)	(3,659)
Present value of minimum payments	$ 23	$ 548	$ 2,680	$ 3,251

5. Operating line of credit:

The Corporation maintains a secured demand operating line of credit (the “Operating Line of Credit”) to finance its working capital requirements. The Operating Line of Credit has a maximum borrowing limit of $15.0 million with increased availability of up to $25.0 million during the Corporation’s peak operating period of April through November of each year, and with the maximum borrowing limit restricted by a lending margin applied to eligible accounts receivable and inventory, subject to an allowance for specific reserves. As at July 31, 2011, the Corporation had available a borrowing capacity of $21.3 million, against which it had drawn $11.6 million. The Operating Line of Credit is secured by a first charge over the accounts receivable and inventories of all the Corporation’s operating entities (except inventories of Top Aces), as well as a floating charge over all other assets of the Corporation and its subsidiaries, except real estate, subject to specific permitted prior encumbrances. The Operating Line of Credit bears an interest rate of 18.00% per annum. As at July 31, 2011, the Corporation was in compliance with all covenants related to the Operating Line of Credit. The original expiry date of the operating line of credit was June 9, 2011. However, the Lender and the Corporation agreed to extend the maturity date of the Operating Line of Credit to September 30, 2011 in order to permit time to complete the documentation of the annual renewal of this facility (see note 14 – subsequent event).

6. Share capital and share-based compensation:

(a) Authorized:

The Corporation is authorized to issue an unlimited number of Class A common voting shares with no par value (“Class A Shares”) and an unlimited number of Class B common voting shares with no par value (“Class B Shares”).

The holders of both Class A Shares and Class B Shares (“Common Shares”) are entitled to receive dividends, as declared from time-to-time and are entitled to one vote per share at meetings of the shareholders of the Corporation. All Common Shares rank equally with regard to the Corporation’s residual assets.

(b) Issued and outstanding

(thousands of Canadian dollars, except for shares)

	July 31, 2011			January 31, 2011		
	Shares		Amount	Shares		Amount
Class A Shares						
Outstanding, beginning of period	134,461,555	$	62,843	134,461,555	$	182,244
Issued on retirement of debt	10,352,000		4,451	-		-
Reclassification of deficit	-		-	-		(119,401)
Outstanding, end of period	144,813,555	$	67,294	134,461,555	$	62,843
Class B Shares						
Outstanding, beginning of period	742,604	$	1,175	742,604	$	1,175
Outstanding, end of period	742,604		1,175	742,604		1,175
Warrants and other equity						
Outstanding, beginning of period	-	$	1,116	-	$	1,116
Outstanding, end of period	-		1,116	-		1,116
Total share capital	145,556,159	$	69,585	135,204,159	$	65,134

On July 21, 2011, the Corporation announced that subject to the approval of the TSX and to final approval of its Board of Directors, it intends to effect a share consolidation (the "Consolidation") on the basis of 10 "old" Common Shares for every 1 "new" Common Share concurrently with or as soon as practicable after closing of the private placement referred to in Note 3, scheduled for September 2011. The consolidation would reduce the number of shares outstanding as at July 31, 2011 from approximately 145,556,159 to approximately 14,555,616. The Consolidation was approved by shareholders at the Corporation's Annual and Special Meeting on June 7, 2011 and is expected to assist with possible future Common Share issues, by allowing certain institutional investors, precluded from investing in the Common Shares at the Corporation's current share price, to acquire Common Shares. Increased institutional ownership may increase the average daily volume of trading in the Common Shares, providing shareholders a more liquid market in the Corporation's securities, and may also reduce bid/ask spreads, resulting in more efficient pricing for both buyers and sellers of Common Shares.

(c) Share-based compensation:

Employee Stock Options (equity settled)

As at July 31, 2011, the Corporation had stock options outstanding that were granted to the officers and employees of the Corporation from two different employee stock option plans. The employee stock option plan created in January 2006 (the “January 2006 plan”) was terminated in June 2008, terminating any additional grants under this plan. All outstanding stock options granted under the January 2006 plan are fully vested. In June 2010, a new employee stock plan (the “June 2010 plan”) was approved by the shareholders.

At July 31, 2011, 4,878,850 Common Shares have been reserved for employee stock options as follows:

	Options outstanding				Options exercisable		
Range of exercise prices	Number Outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price		Number Exercisable	Weighted average exercise price	
$0.26 - $0.49	2,045,000	6.30	$	0.31	-	$	0.31
$0.50 - $1.00	95,000	5.41	$	0.59	95,000	$	0.59
$1.01 - $1.50	309,450	6.56	$	1.24	309,450	$	1.24
$1.51 - $1.75	1,920,200	5.79	$	1.58	1,920,200	$	1.58
$1.76 - $1.85	509,200	5.56	$	1.85	509,200	$	1.85
	4,878,850				2,833,850		

Employee stock option transactions are as follows:

	For the six months ended July 31, 2011		For the twelve months ended January 31, 2011	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Class A Shares				
Outstanding, beginning of period	4,390,800	$ 1.12	3,129,900	$ 1.57
Granted	545,000	0.44	1,500,000	0.26
Exercised	-	-	-	-
Forfeited	-	-	-	-
Expired	(56,950)	1.72	(239,100)	1.60
Outstanding, end of period	4,878,850	1.03	4,390,800	1.12

The Corporation granted options under the June 2010 plan in the current quarter on two separate dates, 200,000 options were granted in May 2011 and 345,000 options were granted in July 2011. The fair value of the May 2011 options of $72,000 and July 2011 options of $121,000 granted under the June 2010 plan was determined using the Black-Scholes option pricing model with the following weighted average assumptions:

Grant date	May 2011	July 2011
Options granted	200,000	345,000
Exercise price per share	$ 0.45	$ 0.44
Risk-free interest rate	2%	2%
Dividend yield	0%	0%
Expected volatility	121%	119%
Expected option life	4 years	4 years
Expected forfeiture rate	0%	0%

The Corporation recognized compensation expense of $21,000 (2011 - nil) in the current quarter and $37,000 (2011 - $5,000) year-to-date relating to the estimated fair value of vesting employee stock options.

(d) Deferred share units (cash settled)

At July 31, 2011, there were 2,365,662 (January 31, 2011 – 2,089,065; February 1, 2010 – 1,308,779) DSUs held by the directors of the Corporation. Each DSU entitles a retiring director to a cash payment equal to the closing market price of the Common Shares on a date selected by the retiring director, which date may not be later than December 31 of the year following the year of the director's retirement. The Corporation granted 118,750 (July 31, 2010 - 266,250) DSUs during the current quarter and 176,596 (July 31, 2010 – 457,741) DSUs year-to-date. The Corporation recognized $56,000 (July 31, 2010 - $56,000) of compensation expense related to DSUs in the current quarter and $130,000 (July 31, 2010 - $106,000) year-to-date. The outstanding DSUs were marked to market at July 31, 2011 which resulted in a $138,000 charge (July 31, 2010 – $91,000 recovery) to earnings in the quarter and a $174,000 charge (July 31, 2010 - $14,000 charge) to earnings year-to-date. No payment was made to retire the DSUs in the current or comparative quarters ended July 31.

7. Earnings per share:

(thousands of dollars except per share amounts)	for the three months ended		for the six months ended	
	July 31 2011	**July 31 2010**	**July 31 2011**	**July 31 2010**
Basic Earnings per Share;				
Earnings attributable to equity-holders of the Corporation	$ 17,979	$ 11,324	$ 15,393	$ 7,397
Weighted average number of common shares outstanding	145,556	135,204	140,466	135,204
Basic earnings per share	$ 0.12	$ 0.08	$ 0.11	$ 0.05
Diluted Earnings per Share;				
Earnings attributable to equity-holders of the Corporation	$ 17,979	$ 11,324	$ 15,393	$ 7,397
Dilutive adjustments:				
- Interest savings from assumed conversion of convertible debt	$ 445	$ -	$ 445	$ -
Adjusted earnings attributable to equity-holders of the Corporation	$ 18,424	$ 11,324	$ 15,838	$ 7,397
Weighted average number of common shares outstanding	145,556	135,204	140,466	135,204
Dilutive adjustments:				
- Assumed conversion of convertible debt	47,260	-	24,022	-
Weighted average number of common shares outstanding assuming dilution	192,816	135,204	164,488	135,204
Diluted earnings per share	$ 0.10	$ 0.08	$ 0.10	$ 0.05

As at July 31, 2011 and 2010, all employee stock options were anti-dilutive.

8. Change in non-cash operating working capital:

(thousands except per share amounts)	for the six months ended	
	July 31 2011	**July 31 2010**
Restricted Cash	$ 200	$ 496
Trade and other receivables	(34,991)	(29,920)
Inventory	(2,380)	(1,212)
Prepaid expenses and other	(2,812)	(1,759)
Trade and other payables	10,134	6,317
	$ (29,849)	$ (26,078)

9. Commitments and contingencies:

The Corporation has annual lease obligations for aircraft and premises. For the three and six month period ended July 31, 2011, the Corporation expensed $4.5 million (July 31, 2010 - $3.9 million) and $6.6 million (July 31, 2010 - $5.6 million) of operating lease payments. Minimum annual lease payments under these non-cancellable leases are due as follows:

(thousands of dollars)	
Less than 1 year	$ 6,613
1 – 2 years	2,100
2 – 3 years	762
3 – 4 years	500
4 – 5 years	387
Thereafter	8,260

The Corporation is committed to the purchase of a fixed wing aircraft for approximately USD $0.9 million in the third quarter of fiscal 2012 and 2 fixed wing aircraft for approximately USD $3.2 million in the fourth quarter of fiscal 2012.

In addition, the Corporation is committed to the purchase of 3 fixed wing aircraft for approximately € 2.9 million in the third quarter of fiscal 2012 and 1 fixed wing aircraft for approximately € 0.8 million in the fourth quarter of fiscal 2012. In connection with the purchase of these aircraft, the Corporation provided a € 0.4 million non-refundable deposit on August 4, 2011 that will be applied to the final purchase price of these aircraft.

10. Segmented information:

The Corporation has two reportable business segments: Northern Services and Government Services. These segments are differentiated by the markets in which they operate. The Northern Services segment comprises Great Slave, Air Tindi and Discovery Mining and the Government Services segment comprises Top Aces, Technical Services and Hicks. The Northern Services segment's primary market is based on activities, and is located, in Northern Canada. The Government Services segment provides specialty aviation related services generally aimed at government entities. All other operating activities not allocated to these two business segments are reported under Corporate Support. Innovations is included in Corporate Support.

Information regarding the results of each reportable segment is included in the following table. Performance is measured based on segment earnings before income tax, as included in the internal management reports that are reviewed by the Corporation's Chief Executive Officer. This measure is used to assess performance because management believes that such information is the most relevant in evaluating the results of the segments relative to other entities that operate within these industries.

(thousands of Canadian dollars)	For the three months ended July 31, 2011				For the three months ended July 31, 2010			
	Northern Services	Government Services	Corporate Support	Total	Northern Services	Government Services	Corporate Support	Total
Revenue	$ 43,534	$ 27,123	$ -	$ 70,657	$ 35,797	$ 21,856	$ 5	$ 57,658
Expenses	25,999	12,883	2,326	41,208	20,712	9,193	1,898	31,803
Depreciation of property and equipment and intangible assets	3,743	2,428	13	6,184	3,750	2,212	11	5,973
	13,792	11,812	(2,339)	23,265	11,335	10,451	(1,904)	19,882
Finance costs				4,719				4,306
Gain on extinguishment of related party debt				(5,900)				-
Gain on sale of property and equipment				(369)				(263)
Share of earnings of equity accounted investees				(245)				(268)
Earnings before income tax				25,060				16,107
Income taxes provision (recovery)								
Current				3,678				4,963
Deferred				3,403				(180)
				7,081				4,783
Earnings and comprehensive earnings				17,979				11,324
Segment assets	$ 150,091	$ 132,474	$ 2,211	$ 284,776	$ 145,036	$ 125,468	$ 1,313	$ 271,817
Capital expenditures	2,379	1,337	159	3,875	1,896	3,501	7	5,404
Investment in equity accounted investees	2,968	39	-	3,007	2,531	-		2,531

(thousands of Canadian dollars)	For the six months ended July 31, 2011				For the six months ended July 31, 2010			
	Northern Services	Government Services	Corporate Support	Total	Northern Services	Government Services	Corporate Support	Total
Revenue	$ 62,081	$ 45,825	$ -	$ 107,906	$ 51,179	$ 32,289	$ 5	$ 83,473
Expenses	44,446	25,087	4,135	73,668	35,524	16,222	3,513	55,259
Depreciation of property and equipment and intangible assets	6,123	4,535	30	10,688	6,317	4,006	32	10,355
	11,512	16,203	(4,165)	23,550	9,338	12,061	(3,540)	17,859
Finance costs				8,470				7,851
Gain on extinguishment of related party debt				(5,900)				
Gain on sale of property and equipment				(115)				(262)
Share of earnings of equity accounted investees				(474)				(344)
Earnings before income tax				21,569				10,614
Income taxes provision (recovery)								
Current				4,241				3,398
Deferred				1,935				(181)
				6,176				3,217
Earnings and comprehensive earnings				15,393				7,397
Segment assets	$ 150,091	$ 132,474	$ 2,211	$ 284,776	$ 145,036	$ 125,468	$ 1,313	$ 271,817
Capital expenditures	4,804	4,031	178	9,013	3,235	4,044	37	7,316
Investment in equity accounted investees	2,968	39	-	3,007	2,531	-	-	2,531

Substantially all the Corporation's revenues are earned within Canada and substantially all the Corporation's non-current assets are located within Canada.

The Government Services segment includes business entities that are economically reliant upon a single customer.

Top Aces' revenue is primarily derived from Standing Offer Agreements ("SOAs") to provide airborne training services to DND. These SOAs were extended in January 2011 for a further 16-month period, with an option in favour of DND to extend the SOAs for an additional twelve months thereafter. DND is not obligated to call up any Top Aces services under these SOAs and may cancel them at its convenience. Top Aces is currently the only supplier with approved airworthiness clearances under these SOAs, and given this fact, together with the essential nature of the services provided by Top Aces, management does not believe it likely that these SOAs will be terminated prior to their expiry, or that there will be any substantial reduction in services required by DND. Top Aces submitted a proposal in October 2010 in response to a Public Works Government Services Canada ("PWGSC") tender of a Request for Proposal ("RFP") for a 10 year contracted airborne training services program with an option in favour of DND for two 5 year extensions. This solicitation was cancelled in early fiscal 2012. The PWGSC will be retendering a new RFP in August 2011 for a 10 year contracted airborne training services program, with an option in favour of DND for a 5 year, followed by a 4 year extension. The tender is set to close on November 1, 2011, and contract award is estimated to be made in April 2012.

Hicks' revenue from aerial fire management services is derived from three 5-year contracts with the Government of Ontario. The continuation of each contract for each new fiscal year is conditional upon a sufficient appropriation of funds by the Government of Ontario. Given the nature of the services being provided, management believes that it is unlikely that the appropriation of funds for these contracts will be discontinued. Any one of the contracts may be terminated by the Government of Ontario (i) upon occurrence of certain events of default, including Hicks' insolvency or its breach of specified material terms or conditions of the contract, and (ii) without cause by giving 30 days prior written notice to Hicks.

11. Explanation of transition to IFRS:

As stated in Note 2(a), these interim condensed consolidated financial statements were prepared in accordance with IFRSs. In 2011 the interim condensed consolidated financial statements of the Corporation were prepared in accordance with Canadian GAAP. The Corporation adopted IFRSs on February 1, 2011, with a transition date of February 1, 2010. The significant accounting policies adopted under IFRSs have been applied in preparing these Interim Condensed Consolidated Financial Statements for the three and six month periods ended July 31, 2011, with comparative information for the same periods in 2010. These significant accounting policies are included in the notes to the Interim Condensed Consolidated Financial Statements as at and for the three months ended April 30, 2011 and 2010.

In preparing its opening IFRS statement of financial position at February 1, 2011, the Corporation has adjusted amounts reported previously in financial statements prepared in accordance with CGAAP. An explanation of how the transition from CGAAP to IFRSs has affected the Corporation's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

(a) Reconciliation of equity at July 31, 2010:

(thousands of Canadian dollars)

	CGAAP	Effect of transition to IFRS	IFRS
Assets			
Current assets:			
Cash	$ 4,378	$ (1,716)	$ 2,662
Restricted cash	834	-	834
Trade and other receivables	39,923	(265)	39,658
Income taxes recoverable	-		-
Inventory	15,151	(456)	14,695
Prepaid expenses and other	4,694	(5)	4,689
	64,980	(2,442)	62,538
Property and equipment	155,301	(7,786)	147,515
Goodwill	37,862	-	37,862
Intangible assets	21,371	-	21,371
Investments in equity accounted investees	-	2,531	2,531
	$ 279,514	$ (7,697)	$ 271,817
Liabilities and Shareholders' Equity			
Current liabilities			
Bank indebtedness	$ 12,115	$ -	$ 12,115
Trade and other payables	16,563	224	16,787
Income taxes payable	1,519	(101)	1,418
Current portion of finance leases	73	(9)	64
Current portion of loans and borrowings	8,967	(190)	8,777
	39,237	(76)	39,161
Finance leases	44	(37)	7
Loans and borrowings	133,016	(793)	132,223
Deferred income taxes	24,572	(1,403)	23,169
Non-controlling interest in equity	2,479	(2,479)	-
Shareholders' equity:			
Share capital	65,134	-	65,134
Contributed surplus	7,146	-	7,146
Retained earnings	7,886	(2,909)	4,977
	80,166	(2,909)	77,257
	$ 279,514	$ (7,697)	$ 271,817

(b) Reconciliation of comprehensive income for the three month period ended July 31, 2010:

(thousands of Canadian dollars)

	CGAAP	Effect of transition to IFRS	IFRS
Revenue	$ 58,390	$ (732)	$ 57,658
Expenses	33,527	(1,724)	31,803
Depreciation of property and equipment and intangible assets	3,435	2,538	5,973
	21,428	(1,546)	19,882
Finance costs	4,314	(8)	4,306
Gain on sale of property and equipment	-	(263)	(263)
Share of earnings of equity accounted investees (net of income tax)	-	(268)	(268)
	4,314	(539)	3,775
Earnings before income taxes	17,114	(1,007)	16,107
Income tax provision (recovery)			
Current	5,048	(85)	4,963
Deferred	(6)	(174)	(180)
	5,042	(259)	4,783
Non-controlling interest	262	(262)	-
Earnings and comprehensive income	$ 11,810	$ (486)	$ 11,324

(c) Reconciliation of comprehensive income for the six month period ended July 31, 2010:

(thousands of Canadian dollars)

	CGAAP	Effect of transition to IFRS	IFRS
Revenue	$ 84,304	$ (831)	$ 83,473
Expenses	57,979	(2,720)	55,259
Depreciation of property and equipment and intangible assets	6,803	3,552	10,355
	19,522	(1,663)	17,859
Finance costs	7,972	(121)	7,851
Gain on sale of property and equipment	-	(262)	(262)
Share of earnings of equity accounted investees (net of income tax)	-	(344)	(344)
	7,972	(727)	7,245
Earnings before income taxes	11,550	(936)	10,614
Income tax provision (recovery)			
Current	3,327	71	3,398
Deferred	(6)	(175)	(181)
	3,321	(104)	3,217
Non-controlling interest	343	(343)	-
Earnings and comprehensive income	$ 7,886	$ (489)	$ 7,397

(d) Material adjustments to the statement of cash flow:

Interest paid and income taxes paid have moved into the body of the Statement of Cash Flows, whereas they were previously disclosed as supplementary information. There are no other material differences between the statement of cash flows presented under IFRSs and the statement of cash flows presented under previous CGAAP.

12. Notes to the reconciliation:

(a) Variable interest entities

The Corporation previously consolidated its interests in variable interest entities under CGAAP. Under IFRS, the Corporation does not control these entities and as a result, these variable interest entities are no longer consolidated but are treated as equity accounted investees.

(thousands of Canadian dollars)

	For the three months ended April 30, 2010	For the six months ended July 31, 2010
Consolidated statement of comprehensive income		
Decrease in revenue	$ (734)	$ (831)
Decrease in operating expenses	2	50
Decrease in finance costs	19	38
Decrease in amortization	121	133
Increase in income tax provision	79	(77)
Share of earnings net of income tax investees (before income tax)	251	344
Decrease in non-controlling interest	262	343
Adjustment to earnings and comprehensive earnings	$ -	$ -

	July 31, 2010
Consolidated statement of financial position	
Increase (decrease) in cash	$ (1,716)
Increase (decrease) in trade and other receivables	(265)
Decrease in inventory	(61)
Decrease in prepaid expenses and other	(5)
Decrease in property and equipment	(4,233)
Decrease in trade and other payables	(226)
Decrease in income taxes payable	101
Decrease in current portion of finance leases	(11)
Decrease in current portion of loans and borrowings	196
Decrease in finance leases	35
Decrease in loans and borrowings	799
Decrease in deferred income taxes	366
Investments in equity accounted investees	2,531
Decrease in non-controlling interest in equity	2,489
Increase in retained earnings	$ -

(b) Componentization of property and equipment

Under IFRS, when parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. This has resulted in a more detailed approach to determining the useful lives of certain asset components under IFRS than was used previously under CGAAP.

(c) Cash-settled share based compensation

The Corporation granted cash-settled share based payments to directors (note 6). The Corporation accounted for these share based payment arrangements by reference to their intrinsic value under previous CGAAP. Under IFRS the related liability is recorded at fair value of the outstanding cash-settled share based payments, which is not materially different from the amount determined under CGAAP.

(d) Reclassification of Cash from Held for trading under CGAAP to Loans and Receivables under IFRS

Cash does not meet the criteria for the fair value through profit and loss designation under IFRS because cash is not managed on a fair value basis but on a yield to maturity basis and because cash is not traded on an active market. Under CGAAP, cash met the applicable criteria and was classified as held-for-trading.

As a result of the Corporation's adoption of IFRS, cash will be classified under loans and receivables. This change in classification constitutes a disclosure difference and does not have a financial impact on the consolidated financial statements because the fair value of cash approximates cost.

(e) Reclassification within the statement of comprehensive income

The Corporation chose to present the statement of comprehensive income by nature.

Amortization of rotable and overhauled components was included in operating expenses under previous CGAAP. These costs are now included within depreciation under IFRS.

(f) Taxes

The above changes decreased the deferred tax assets/liabilities as follows based on a tax rate of 26%.

(thousands of Canadian dollars)		**July 31, 2010**		**January 31, 2011**
Componentization of property and equipment	$	(1,037)	$	(958)
Variable interest entities		(366)		(319)
Change in deferred tax liability	$	(1,403)	$	(1,277)

The effect on the statement of comprehensive income for the year ended January 31, 2011 was to increase the previously reported tax charge for the period by $69,780.

(g) Retained earnings

The above changes decreased retained earnings as follows:

(thousands of Canadian dollars)		**July 31, 2010**		**January 31, 2011**
Componentization of property and equipment	$	(1,872)	$	(3,659)
Deferred income taxes		(1,037)		958
Change in retained earnings	$	(2,909)	$	(2,701)

13. Comparative figures:

Certain comparative figures have been reclassed to conform with the current period's financial statement presentation.

14. Subsequent event:

The Corporation and its Lender agreed to extend the maturity date of the Corporation's existing operating line of credit from June 9, 2011 to September 30, 2011 in order to complete the documentation of the annual renewal of this facility. The renewal is for another one year term, with minor modifications to certain terms and conditions and with a reduction in the annual interest rate from 18% to 13%. The aircraft term loan provided by the same Lender will also be renewed for another 1 year term at 13% per annum.