

CALIAN



2010

Annual Report  
Calian Technologies Ltd.

The background of the page features a light gray grid pattern. In the lower-left quadrant, there are several stylized autumn leaves in shades of orange, red, and brown, along with thin, light gray branches. The right side of the page is a solid olive green color.

## Table of Contents

1	Message from the Chairman
3	Message from the President and CEO
4	Report on Operations - Systems Engineering
5	Report on Operations - Business and Technology Services
6	Business of the Company
8	Management's Discussion and Analysis of Financial Condition and Results of Operations
28	Management's Statement of Responsibility
29	Auditors' Report
30	Consolidated Statements of Earnings and Retained Earnings
31	Consolidated Balance Sheets
32	Consolidated Statements of Comprehensive Income and Accumulated Other Comprehensive Income (Loss)
33	Consolidated Statements of Cash Flows
34	Notes to the Consolidated Financial Statements



## Message from the Chairman

Fiscal 2010 was yet another exciting year for Calian. While always mindful of the unsettled economic environment, our management team remained focused on the quality of our services and the related satisfaction of our customers.

The dynamic business environment of the last year warranted operational adjustments in certain segments of our business while at the same time requiring diligent project execution in others. Overall, management rose to the challenge and was able to produce excellent results despite the uncertainty in today's economic and political landscape.

Our board has both the breadth and depth of experience required to provide management with effective and appropriate advice. Our board of directors and our management team are well aware of the responsibilities that you as shareholders have entrusted to us. Accordingly, corporate governance, business ethics and risk awareness are always at the forefront of our decisions, whether it be in high-level guidance provided by the board or in day-to-day execution by management.

I also share management's enthusiasm for the future. Armed with a strong balance sheet and a seasoned management team, I am confident in our ability to address both the challenges and the opportunities that will certainly arise in the year ahead.



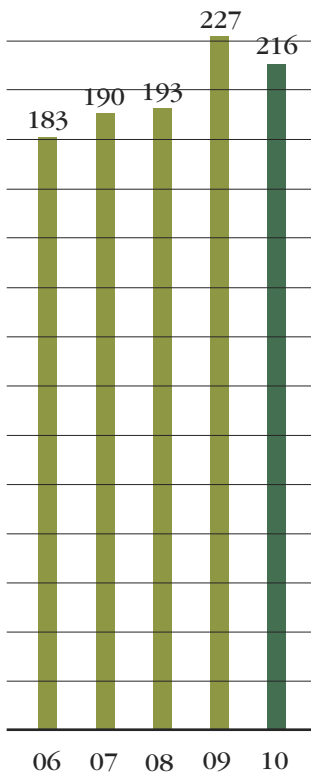
**Kenneth Loeb**

*Chairman*

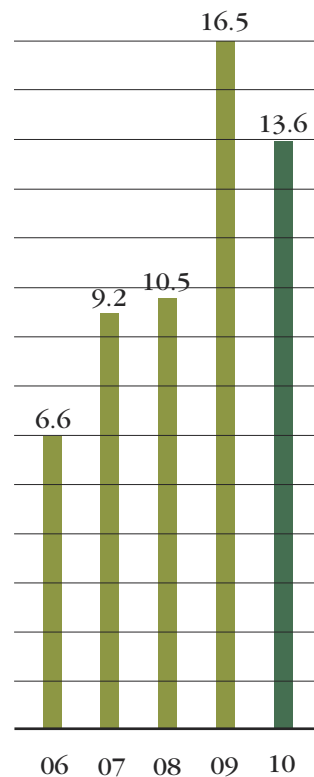


(millions of dollars, except per share data)

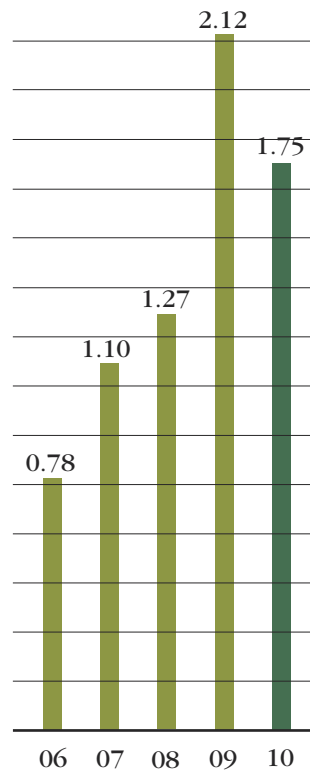
### Revenues



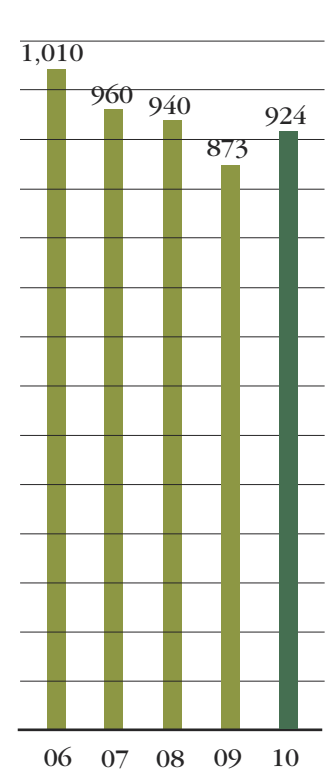
### Net Earnings



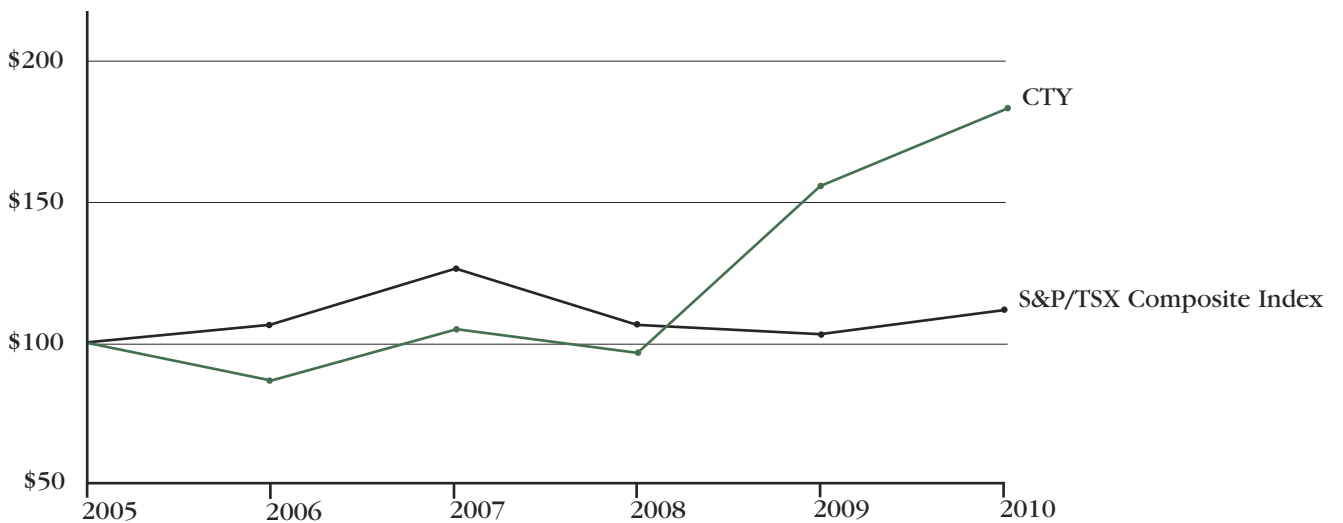
### Earnings Per Share (basic)



### Backlog



### Comparison of Cumulative Total Return



## Message from the President and CEO

2010 was a year marked by considerable challenges and accomplishments for the Company. On one hand, we were faced with hesitant markets for our commercial products and services along with diminished requirements from our US-based manufacturing customers. At the same time, we were able to secure renewals for existing contracts and win new work for long-term operations services with the Department of National Defence and other government customers. Fortunately, the diversity of our service offerings allowed us to apply a measured and controlled approach to the unsettled economic environment and to make the necessary adjustments to our operating strategies and processes. As predicted, we experienced a decline in revenues relative to the records set last year and returned to more traditional levels of profitability, still a strong showing considering the business climate over the last year.

Our two divisions continue to provide a wide range of quality systems and services to a variety of blue chip customers. It is this quality and diversity that allows us to excel, even during difficult economic times.

As expected, our SED division did not duplicate the stellar results achieved in 2009. The satellite engineering group had anticipated significant challenges as major programs ended and economic turbulence further constrained new ventures. Against that backdrop, I am very pleased with the division's ability to source and execute new work, not only from traditional customers, but from new ones as well. In addition, our contract with the European Space Agency for a third deep space antenna provided substantial contributions to revenues. While we were able to expand revenues from our commercial manufacturing customers such as Research In Motion (RIM), it was not sufficient to offset the considerable slowdown in requirements from our US-based military customers. However, while overall revenues dropped and a strengthening Canadian dollar continued to weaken our export position, we were able to protect margins and produce an operating profit percentage that is still considered very healthy for a systems integrator operating in an international marketplace.

In the midst of constrained government spending, our BTS division was still able to retain the significant increase in its revenue base produced in the prior year. Of equal importance, we once again successfully renewed major long-term outsourcing contracts and also won contracts for new requirements from DND, our major customer. The outsourcing group now has a multi-year backlog of secure profitable work and is well positioned for the future. In a slow commercial marketplace, our staffing group experienced ongoing challenges. However, these were largely offset by an uptake of our staff augmentation offerings by the federal government; a testament to our long-standing reputation for quality staffing services within the public sector. Overall, revenues and operating profit for the BTS division were consistent with the prior year. More importantly, we have built a significant base of work from which to grow in future years.

On a consolidated basis, we achieved revenues of \$216 million and earnings per share of \$1.75. While short of the unprecedented levels attained in the prior year, these results represent a strong showing in today's uncertain business environment and a steady progression from traditional levels. These strong earnings are the direct result of our prudent and risk-aware approach to business along with a continuous focus on gross margins, operating costs and cash flows.

During the year, we twice increased our quarterly dividend rate, which now stands at \$0.22 per share. Total dividends, including the \$1.00 special dividend, were \$1.79 per share for the year. Overall, when share appreciation and dividends are combined, our shareholders have realized a return of 17% for the year, over double the return for the TSX as a whole. We are very proud of our track record of dividend growth, which equates to a compound annual growth rate of 22% over the last 5 years. At the same time, we are very cognizant of our commitment to generate sufficient profitability and cash flows to support that growth. In order to further enhance shareholder value, we continued our share repurchase program throughout the year, purchasing 148,000 shares at an average price of \$17.43 per share.

In summary, I am extremely pleased with very solid results for the year. Our management team remained focused on execution and customer satisfaction, key ingredients for navigating in unsettled times and for keeping the Company on course for future growth. Our past performance and our reliable business practices will ensure continued loyalty from existing customers. At the same time, our strong balance sheet provides the staying power to deal with today's volatility while remaining poised to take advantage of tomorrow's new and emerging opportunities.



A handwritten signature in black ink that reads "Ray Basler". The signature is fluid and cursive, written in a professional style.

**Ray Basler**

*President and CEO*





## Report on Operations - Systems Engineering (SED)

As expected, 2010 was a challenging year for the SED division. As the year began, we saw a significant decline in the level of business with one of our key contract manufacturing customers. At the same time, three of our large earth station integration projects were completing and there were fewer opportunities to fill the void. Despite these challenges, we were able to record revenues of \$64 million and divisional contribution of \$11.2 million, or 17.5%.

On the manufacturing side, our business with KDS for Control Electronics Processors and harnesses declined significantly from previous levels. With recovery unlikely to occur within the foreseeable future, we were forced to reduce our manufacturing staff by 25 per cent. Since these reductions, the KDS work has leveled off at the forecast levels. Fortunately, we received several orders from DRS for Arial Head Assemblies for their MSTAR Radar. In addition, our work with RIM increased well beyond anticipated levels. In addition to basic integration of test sets, we are now manufacturing related circuit boards and cables, which increases our value added contribution on the project. Despite the reduction in our KDS work, our manufacturing business generated 30 per cent of our revenues in 2010.

Two of our major satellite communications integration projects were completed during the year. We finished the installations of two earth stations for Terrestar and compatibility tests were performed with the satellite in early 2010. Installation and commissioning of the four earth stations for Mobile Satellite Ventures was achieved in Q3 of 2010. Compatibility testing with the satellite has been delayed to 2011 as a result of satellite launch delays. During the year we were also successful in winning a contract to provide Inmarsat with two earth stations to support the WAAS navigation system. These stations have been installed and commissioned in New Jersey and Hawaii.

Work continues on the third deep space antenna for the European Space Agency which was signed in early fiscal 2010. The design is now complete and construction of the antenna pad and concrete tower has begun on site in Malargue, Argentina. All of the major sub-contracts have been signed and the major equipment placed on order. The project is proceeding according to plan.

Our Network Management group completed the installation and commissioning of the two Aeronautical Ground Earth Stations for Inmarsat. This project was done against a very aggressive schedule with demanding technical requirements. Successfully completing the project on time has greatly enhanced our reputation with Inmarsat and a number of key organizations within the Aeronautical community. Our Network Management group was also successful in winning a contract to provide Skywave three Access Control and Signaling Systems for their Inmarsat data service. These systems are to be installed in Canada, the Netherlands and New Zealand. The project is currently in the integration phase with Installation expected to begin in the fall. In addition to these projects we continued to do upgrades for a number of systems that we had previously provided to Inmarsat and Sirius XM.

Our satellite operations contracts continue to generate a steady profitable stream of business. We have been providing operations services for the Radarsat 1 and Scisat satellites under contract to the Canadian Space Agency for the past 15 years and during the year we renewed the contract for an additional two years. We have also been providing operations services for the Radarsat 2 satellite under contracts to MacDonald Dettwiler (MDA) and Telesat since the satellite launch in December 2007. We are now providing primary operations for the Ciel-2 satellite using our new gateway facility in Saskatoon. This facility is also used to house the antennas and satellite communications equipment for SkyTerra. This new gateway facility provides the core capability to allow us to expand our business in satellite operations.

In conclusion, although 2010 was a challenging year for the Systems Engineering Division, we were able to generate respectable revenue levels and provide solid divisional contribution. As we enter the new year, our seasoned management team and professional work force remain committed to customer satisfaction and continuous improvement.



**Brent McConnell**

*VP and General Manager, Systems Engineering*

## Report on Operations - Business and Technology Services (BTS)

In 2010, the Business and Technology Services Division faced an unsettled business environment. The impact of a period of fiscal restraint with one of our largest customers resulted in both year over year revenue and divisional contribution being flat when compared to the prior year results. The Outsourcing Services Department (OSD) completed the renewal cycle for its major contracts during the year and the Staffing Services Department (SSD) successfully transitioned the technical support work previously performed for Nortel to four of the successful bidders for the Nortel business units.

Our OSD group achieved the majority of their performance objectives during the year. The award of a six-year support contract at the Royal Military College in January 2010 highlighted the successful completion of the contract renewal cycle for the Department's major contracts with the Department of National Defence (DND). Over the past two years the OSD group competed for and won approximately \$440 Million of long-term support contracts with DND restoring the contract backlog to traditional levels. During the current year, new contract wins in support of the Canada Defence Academy and DND's National Maintenance Contract also provided new opportunities for non-traditional technical and training support to our largest customer; at the same time further increasing the Company's presence at Canadian Forces (CF) bases across the country.

Our SSD group experienced a mixed year as fierce competition in both the private and public sectors impacted both revenue and gross margins. The group had a very successful year in the public sector as it expanded business at the Federal level and successfully qualified for the Ontario Government's IT Vendor of Record. This success in the public sector was at the expense of reduced gross margins and accordingly we initiated a heightened emphasis on controlling operating costs. The private sector market started to show improvements near the end of the year with increasing activity in the banking and retail sectors. Diligent work with the successful bidders for the Nortel assets resulted in the addition of four new customers to the Division and the preservation of our traditional technical support business in the telecommunications sector. The SSD group is now well positioned for significant growth in the coming years.

Our back office functions of Human Resources, Finance and Business Information Systems, working closely with the operating business units, successfully completed a major upgrade to our backbone SAP information system. This upgrade was completed on time and under budget and represents the initial step in our renewed business excellence efforts. Realignment of our information systems and making further improvements in scalability is the foundation on which our future operating costs will be controlled and our long-term competitiveness maintained and ultimately improved.

The completion of the OSD contract renewal cycle allows for the redeployment of resources into the pursuit of new business with the intent of expanding our public sector market share. At the same time our contract backlog has been replenished and presents ongoing opportunities for increased organic growth within these contract vehicles. The private sector market place is improving for our SSD group and our ongoing cost control initiatives are expected to improve our competitiveness as the year progresses.

As previously announced, I will be retiring in early 2011. I am very proud of the progress made by the division over the past number of years and have every confidence that my replacement, Kevin Ford, will carry on the traditions of continuous improvement and controlled profitable growth.



**Tom Coates**

*VP and General Manager,  
Business & Technology Services*



## Business of the Company

### **Calian sells technology services to industry and government.**

We operate through two autonomous divisions that complement each other and that share the vision and key tenet upon which Calian has emerged as a technology services leader — effective and prudent management with a focus on sustainable growth in carefully selected markets.

The diversity of our service offerings is at the heart of our success. By serving a number of customers in several different and geographically varied markets, we benefit from a diversity that helps us weather the downturns experienced in any one market and that allows us to take advantage of unique opportunities as they arise. This diversity is most evident when comparing the business of our two divisions.

**Systems Engineering** designs and manufactures complex systems. Our primary markets are the satellite communications arena and the defense and homeland security sectors. We are a small niche player serving a handful of multi-national organizations working on large worldwide projects. More than 70% of our annual revenues are derived from exports.

Our approach is simple. We tailor systems to meet individual customer needs, using advanced commercial equipment from reliable suppliers. This means less development, lower risk and cost, and faster delivery. Our customers value being able to delegate the development of large and complex systems to us, confident that our technical and management skills will deliver what we promised, when we promised it, and at the agreed price. Our core competencies make us stand out from our competitors — strong project management, systems engineering know-how, and software development capabilities. Our full-service approach addresses needs from design through long-term maintenance, helping our customers roll out new services on time and manage them profitably. We routinely enjoy repeat business due to the strong relationships we have established with industry leaders.

The same core competencies are applied to the manufacturing services we provide to military prime contractors and equipment suppliers. The value added by our technical expertise and our focus on high-reliability, low-volume production of complex systems differentiate our services from those of our competitors.

**Business and Technology Services** provides people to help customers manage their changing workforce requirements. We provide ready access to an exceptional team of engineering, technology, administrative and health care professionals. The division caters mainly to the Canadian federal government, with a large presence in the Department of National Defense, and also has a well-established private sector customer base that is expanding. About 2% of annual revenues are derived from the United States.

The services we offer allow our customers to focus their vital internal resources on key priorities. The value we add lies in the breadth of services we offer and our ability to source sufficient and appropriate resources on a timely basis to meet our customers' requirements. This is due to our exceptional recruiting capabilities, effective management of our employees in the field, and competitive rates.

**A comparison of the business models and operating approaches** of the two divisions further illustrates the diversity between them.

Contracts in Systems Engineering are technically complex and are typically on a fixed-price basis with demanding requirements to meet delivery schedules. The division operates essentially under a fixed-cost structure, requiring the careful management of labour utilization. The majority of revenues are derived from international sources and contracts are often denominated in foreign currencies. While the risks are high, the margins are commensurate.

Contracts in Business and Technology Services are typically on a per-diem basis and can range from short-term assignments to multi-year operations and maintenance contracts. The cost structure of the division is variable as direct labour costs are scalable to match contract requirements. The majority of revenues are derived from Canadian sources so there is little currency exposure. With a reduced risk profile, margins are correspondingly lower.



Systems Engineering's billings are based on achieving well defined project milestones. These can be in advance of, or subsequent to the recognition of revenues. Milestone profiles vary depending on factors such as the customer, competition and pricing. Accordingly, cash flows and working capital requirements can vary significantly from project to project and over the life of any one project. In Business and Technology Services, cash flows are very predictable as most contracts call for monthly billings of work performed.

From the perspective of renewing business, Systems Engineering is awarded one project contract at a time, usually as a result of winning an open international competition. Constant marketing efforts are directed towards identifying and securing bid opportunities and a significant overhead effort is required to develop detailed proposals for new projects. The situation is similar for the short-term staffing component of the Business and Technology Services division, which requires ongoing marketing and sales efforts to maintain the backlog. However, the longer-term outsourcing component of this division enjoys the benefit of multi-year contracts that often contain provisions for extensions, offering long-term visibility of future revenues.

Overall, the diversity in markets, customers and business models provides Calian with an enviable balance in its consolidated business.

## Management Team



**Ray Basler**

*President and CEO*



**Jacqueline Gauthier**

*VP, CFO and Corporate Secretary*



**Tom Coates**

*VP and General Manager,  
Business & Technology Services*



**Brent McConnell**

*VP and General Manager,  
Systems Engineering*

## Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis is dated December 3, 2010 and should be read in conjunction with the audited consolidated financial statements and notes included in this annual report. The Company's accounting policies are in accordance with Canadian generally accepted accounting principles (GAAP) of the Canadian Institute of Chartered Accountants. As in the consolidated financial statements, all dollar amounts in this Management Discussion and Analysis are expressed in thousands of Canadian dollars unless otherwise noted.

### Forward Looking Statements

The Company cautions that the forward-looking statements in the following Management Discussion and Analysis are based on certain assumptions made by the Company that may prove to be inaccurate. Forward-looking statements include those identified by the expressions "anticipate," "believe," "plan," "estimate," "expect," "intend" and similar expressions to the extent that they relate to the Company or its management. These forward-looking statements are not historical facts, but reflect the Company's current expectations and assumptions regarding future results or events. Assumptions made include customer demand for the Company's services, the Company's ability to maintain and enhance customer relationships, as well as the Company's ability to bring to market its services. Furthermore, the Company cautions that the forward-looking statements in the following Management Discussion and Analysis are based on current expectations as at December 3, 2010 that are subject to change and to risks and uncertainties including those set out under the heading "Risk Factors" below. Actual results may differ due to facts such as customer demand, customer relationships, new service offerings, delivery schedules, revenue mix, competition, pricing pressure, foreign currency fluctuations and uncertainty in the markets in which the Company conducts business. Additional information identifying risks and uncertainties is contained in the Company's filings with the various provincial securities regulators. Readers should not place undue reliance in the Company's forward-looking statements.

### Business Overview and Strategic Direction

Calian sells technology services to industry and government. For many years, industry and government have searched for and adopted new operating models and new technologies in an effort to improve the efficiency of their operations. Management expects that they will continue to do so, and in recognizing this trend, the Company has built a unique combination of specialized skills and available capable resources in order to address the resulting market opportunities.

With these capable resources at the ready, Calian can quickly assemble and deploy teams of professionals with the requisite skills to promptly assist customers implement their diverse operating and technology needs, whether it is the design and integration of a complex satellite ground system or the provision of specialized training, project management and operations services.

Calian's larger mainstream competitors often cannot duplicate the timeliness and reliability of Calian's services. Furthermore, efficient and flexible operating processes, combined with a strong financial condition allow Calian to profitably address lower margin business without compromising quality or performance, and this further distinguishes the Company from its competitors. Due to the Company's successful delivery and execution of projects, Calian experiences repeat business and a large number of contract renewals.

Calian's long-term direction is to continue to focus on providing its current service offerings to industry and government in specialized niche areas outside the mainstream market, avoiding competition with larger competitors. Calian will concentrate on those opportunities that entail agility and flexibility in both resources and capabilities to address customer requirements, be it in our traditional markets or new ones with similar needs.

Calian's growth plans include building upon and expanding its current capabilities and addressing a wider range of customers with a broader range of services without compromising its commitment to quality and delivery. Calian plans to continue augmenting its service offerings and capitalizing on its reputation for delivery, building on its satisfied base of blue-chip customers. In addition, the Company plans to continue to look for and acquire specialized companies that have also had success in profitably addressing niche markets and whose operating philosophies align with those of Calian. With growing revenues, an efficient back office, and the realization of economies of scale, the Company's objective is to enhance the returns to its shareholders and build an enterprise that excels in its selected markets.

For existing operations, the key is controlled profitable growth. Management expects that growth will not only extract economies of scale and provide additional returns, but will also provide an environment for its people to grow and advance within the Company. Calian's strengths in delivering specialized services in niche markets have so far permitted the Company to excel in a difficult business environment where many mainstream competitors have faltered. With this backdrop of continuing to do what Calian does best, there are no plans to materially alter the business of the Company.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Calian currently operates in two reportable segments, defined by their primary type of service offerings:

Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector. The Systems Engineering Division, also known as SED, has its principal office in Saskatoon, Saskatchewan.

Business and Technology Services involves both short and long-term placements of personnel to augment customers' workforces as well as the long-term management of projects, facilities and customer business processes. The Business and Technology Services division (BTS) has its principal Canadian office in Ottawa, Ontario and its US office in Virginia.

As both of our divisions operate in very specific niche areas within large markets, there exists very little third party data to compare to the Company's performance. Although referring to the general market trends provides insight into the health of those markets and some clarity on the opportunities within those markets, it is not indicative of the health, demand and funding of the individual customers of the Company. In order to compensate for this limited insight and to provide an indication of revenue potential, this annual report provides a detailed rollout of the Company's backlog by division showing both contracted backlog and option renewals by fiscal year.

In addition, since referencing pricing or volumes of production are not applicable to our business to allow a proper understanding of the level of revenue generated during the year or expected in the future, the following discussions reference to the types of contracts performed by each of the two divisions will provide some insight into the level of customer specific demand for our services.

### Systems Engineering Division

For over 45 years, SED's core strength has been communications systems engineering. SED builds equipment, systems, and networks to maximize utilization, efficiency and throughput. Its primary market is the satellite industry, but it also applies its capabilities and expertise to broader adjacent markets with needs for similar systems and services.

SED is a systems integrator and works with its customers on a project basis to develop custom systems tailored to their specific operational requirements. From one project to the next, SED attempts to reuse system architecture, core software modules, and custom hardware designs to reduce development time, cost and technical risks. SED's manufacturing facility, initially created to support its communication systems engineering group, now accounts for a substantial portion of the revenue base and provides an on-going base of business that helps offset the ebb and flow of core project work.

SED's strengths are renowned around the world with exports typically accounting for more than 70% of annual sales. This compares to a Canadian space industry average of 50%. Customers often request deployment our systems to other locations. We now have systems operating on six continents and we are well versed in the logistics associated with international installations.

SED designs and manufactures equipment for the satellite ground-based infrastructure market and systems must be upgraded or replaced on a regular basis. The introduction of HDTV and the wide acceptance of Digital Audio Radio are also presenting opportunities for additional capacity and enhancements. With recent world events, demand for reliable mobile communications for disaster relief and satellite news gathering has now become center stage. Additional demands are being driven by applications like mobile broadcast, military use of commercial satellites and the ongoing need to replace the existing capacity of satellites approaching end-of-life.

Overall, the business environment for the SED division is stable and sustainable. Inmarsat and Intelsat are increasing capital spending after both having operated under restricted capital expenditure philosophies. This should bode well for integrators such as SED. However, reduced credit availability continues to hamper the ability of start-ups and certain existing players to get the funding or refinancing needed to drive their initiatives forward. Competition continues to be fierce as competing companies look to fill their available capacity.

While the satellite communications sector has been the core of SED's business, the contract manufacturing group continues to provide a substantial base of revenues. Although the levels of activity peaked in 2009 and have since abated, the regular base of work SED receives from several key customers continues to provide the manufacturing group with respectable levels of utilization. We focus on opportunities requiring low volume and high reliability manufacturing; qualities that are well suited to defence applications. These attributes also provide effective immunization from offshore competitors.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

In 2010 the SED division performed well despite the expected drop in our manufacturing business. During the year, SED signed \$79 million in new contracts and ended the year with a backlog of \$74 million of which \$41 million is expected to be earned during 2011.

Satellite Operations continue to provide a steady revenue stream. SED continues to operate both of the Radarsat Satellites under contract to the Canadian Space Agency (CSA) and MDA. SED has expanded its customer base and now provides satellite operations to Ciel for the Ciel II satellite. SED is also under contract to host SkyTerra's communications gateway equipment in a building adjacent to our current facility in Saskatoon.

Early in 2010, SED received the final contract from ESA for the provision of a third 35-metre deep space antenna and RF system destined for installation in South America in 2012. This \$24 million increase brought the full contract value to \$39 million to be earned over three years. As activities ramped up quickly, it was a major contributor to SED's revenue base in 2010 and is expected to be in 2011 as well. In addition, during 2010, SED was awarded a contract to provide operations and maintenance services for the CSA Satellite Operations Directorate at its facilities in Saint-Hubert, Quebec and in Saskatoon, Saskatchewan. The contract runs until March 31, 2012 and is valued at over \$10 million. This contract is a continuation of work SED has performed for CSA since 1994 and involves services that support CSA's current satellites Radarsat-1 and SciSat-1.

While our manufacturing group was downsized during 2010 to reflect the decreased level of activity relative to the peak in 2009, this segment of our business is still a strong contributor to revenues and profitability. Overall, more than \$24 million of new orders were signed during the year. Our manufacturing related revenues are derived mainly from harnesses and electronic modules for KDS and Arial Head Assemblies for DRS; legacy products that SED has been manufacturing for a number of years. The area of highest growth within the manufacturing group is the assembly of test sets for RIM used in the manufacture of their popular Blackberry smartphones. The level of test set assembly increased during 2010 due to the number of new phone models introduced. Also, we started manufacturing certain component parts for the test sets as well as for RIM's internal consumption.

The markets in which SED operates are stable and we expect new opportunities to surface during the year ahead. In addition our manufacturing base is expected to stay at levels consistent with those experienced in 2010. In the communication business sector, in addition to the ESA Third Deep Space Antenna, SED expects to work closely with Inmarsat as they continue to evolve and expand their service offerings. In the digital audio broadcast market, we anticipate additional business with Sirius/XM Radio as they seek to realize further merger related efficiencies and also strive to bolster their product offerings. In the test systems area, we expect a solid level of business from RIM test sets and we will continue to pursue opportunities with our traditional test systems market for Communications Monitoring Systems and In-Orbit Test Systems. Finally, within our network management business, we will continue to exploit our resource management software as well as pursue further sales of our ancillary satellite products.

As worldwide competitors continue to vie for market share, margins are expected to come under pressure. Continued strength of the Canadian dollar relative to other major currencies could also weaken our export position.

### **Business and Technology Services Division**

BTS is a leader in the business and technology services field, providing professional and technical personnel to meet and anticipate its customers' unique needs. Across Canada and in parts of the USA, we have a workforce in excess of 2,000 individuals in both full and part-time capacities. Our primary market is the Canadian federal government with an emphasis on the Department of National Defence (DND), but we also provide services to large multi-national and Fortune 500 companies as well as to other departments within the federal government and to the Governments of the United States, Spain and Australia.

We are in the people business. We work with our customers to define their needs and satisfy their requirements through short and medium-term placements of personnel to augment customers' workforces (Staffing) or through the long-term management of projects, facilities and customer business processes (Outsourcing).

The division's success comes from its focus on delivering a quality service through careful attention to both customer and contractor needs. BTS is a continuous improvement organization and is accredited to Level 4 under the Progressive Excellence Program of the National Quality Institute of Canada. In 2009, BTS received a gold level Canada Award of Excellence for Health and Wellness.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

Over the past several years, we have continued to build and enhance our reputation as a very competent, high quality, but reasonably priced, supplier. We have consciously focused on niche markets that do not attract significant attention or large numbers of competitors. This strategy has allowed us to maintain our prices and effectively develop a capability that few of our competitors can match.

The major market for our BTS division continues to be the Canadian Federal government with an emphasis on DND, particularly for outsourcing services. DND continues to be a priority for the federal government especially as it relates to strengthening personnel in both the regular and reserve forces and to supporting increased training and medical care. Both of these priorities target areas of expertise within the division. DND has started to involve private contractors in all facets of their training to free up their relatively scarce military personnel for mission critical operational duties. The BTS division is well positioned to take advantage of the increased training requirements in areas where the shortages are most prominent.

Demographics continue to work in our favour within the marketplace. Due to retirements, large corporations along with various Federal Government departments and the military continue to lose large numbers of employees with in-depth knowledge of their internal workings. In many cases the remaining employees are not yet able to assume additional responsibilities. This has created a necessity for these entities to re-acquire this lost knowledge. The BTS division has placed a special emphasis on attracting retirees with their extensive corporate knowledge and expertise, and accordingly has been successful in assisting them in bridging the knowledge gap while they train and mentor replacement staff. At the present time, we continue to see increased demand for this solution and will continue to take advantage of this trend to provide "ready made" support services to our customers.

In order to cope with the backlog of procurement, federal government departments are implementing new processes and tools. In the Information Technology and Management (IT/IM) arena, the trend to larger, more complex ERP systems continues. New installations continue to provide opportunities; however system upgrades, enhancements and migrations are assuming an ever increasing share of the IT/IM budgets and hence our business opportunities. This is particularly the case in many larger organizations where legacy system databases are being mandated to interface with these ERP systems. Within the federal government particularly, there is not only a need for new applications but also a need to provide access to both the application and the information in its underlying database. Government wide, there is a greater focus on developing and supporting wider web access coupled with an even greater attention to the associated security concerns of protecting the users and their data. Accordingly, we continue to focus on related business development activities and the investment of internal resources to accommodate these new approaches.

2009 was a year of significant contract renewal activity for BTS, particularly within OSD where numerous multi year contracts (6 to 9 years in duration) were successfully retained within DND, effectively allowing us to dominate this niche training market. These wins coupled with the renewal in 2010 of the division's remaining long-term contracts ensures many more years of stability allowing us to seek out and exploit new niche markets.

Albeit a smaller portion of our revenues, the private sector continues to feel the effects of the economic crisis and certain key customers have struggled. We have seen some improvements in 2010 and are hopeful that the positive trend will continue.

All in all, despite the current impediments created by global financial instability that has had significant impact on our private sector business, we continue to believe that the long-term business environment in the public sector for the services of the BTS division remains favourable, and will more than offset any private sector slow down for the foreseeable future.

2010 has been a year of solid performance. The Health Service Support Contract (HSSC) with DND grew this year over the prior year as a result of increased demand for professional resources. Similarly, the DLSE (Directorate of Synthetic Land Environments) contract generated organic growth as DND ramped up its training activities under a contract renewal obtained in the second half of 2009. This contract is expected to continue running strong into 2011 as the team continues to support various DND training initiatives.

During 2010 BTS completed its renewal cycle by renewing a Standing Offer with the DND to provide the Royal Military College (RMC) with the services of researchers to perform research activities, on an as and when requested basis. The initial five-year period covers January 1, 2010 to December 31, 2014 with an option to extend the Standing Offer for a further one-year period, for a potential value of \$60 million over the six year duration. This standing offer will allow Calian to continue to provide research assistance to University Teachers at RMC who carry out research and development in the broad disciplines of engineering, science and humanities. This new agreement allows Calian to further its relationship with RMC which began in 1997.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

BTS was also successful in winning new contracts in 2010 among those were:

- An award by DND to expand the training services it currently provides to DND through the supply of services to support Basic Military Qualification (BMQ) and Primary Leadership Qualification (PLQ) training in three streams: Administrative Support, Training Support, and Instructional Support. Individuals will fill a wide range of positions, including role players, military occupation instructors, training support supervisors and exam/test invigilators. This contract commenced in January 2010 and may extend as far as May 31, 2015 with a full contract value estimated at approximately \$65 million.
- An award by DND to deliver maintenance services in support of DND activities at five main Canadian Forces Army bases across Canada and carry out the full range of maintenance services on Class "B" (non-armored) vehicles under a single contractual arrangement. This requirement is for a two-year period plus a one-year option and encompasses all maintenance, mandated modifications and inspections, as well as preservation of equipment across the Army. The overall contract value is approximately \$24 million if the option year is exercised. Under the contract, Calian will augment military vehicle technicians through the provision of vehicle and trailer maintenance services. Calian will plan, hire and deploy technicians to deliver the various vehicles and trailer maintenance services at these five main Army bases.

BTS enters 2011 with a strong backlog of work and excellent opportunities on recently submitted proposals. In the coming year, we believe our existing contracts are well positioned to experience organic growth; however revenue growth from new opportunities will be greatly influenced by the timing of both the actual competition and the subsequent contract award.

With the Health Services Support Contract (HSSC), we are considered a major player in private sector health care delivery. The existing DND contract has funding room for significant increases in activity but these have not yet materialized and increased investment in mental health resources has yet to impact our contract. Until any new resources are authorized, we do not expect to see significant growth within this contract and we presently do not expect authorization to occur in the coming year. However, we continue to meet with some success in signing small contracts for the supply of physicians to other smaller government departments. These contract wins have opened the door for us to pursue increased requirements within these departments and our challenge in the future is to demonstrate that the DND model can be tailored to fit their smaller health care environments.

The IT/IM markets continue to offer significant potential. The increasing complexity of both business and government, coupled with the ever increasing demand for information is driving the need for sophisticated information management and information sharing systems. The level of sophistication, particularly in the ERP realm, often requires specialized resources not often found in-house and accordingly is driving demand for outside specialists. Our traditional staffing model and our expertise in the areas of general IT and ERP puts us in a strong position to address these requirements. Our SSD service offerings are well positioned and competitively priced in the local Ottawa market and we continue to increase our level of business within our key customer departments. At the same time, we started to see a resurgence of activity in the Toronto market place and improved uptake of our offerings there. Our selection as to the Vendor of Record Agreement for IT Resources with the Ontario Provincial Government is expected to both increase and diversify our revenue streams in this market. The omnibus IT staffing supply arrangement for the Federal Government, called TBIPS (Task Based Information and Professional Services) is now the contract staffing vehicle of choice for the majority of Federal Government Departments and we have been very successful in winning new business under this vehicle. We expect that this success will continue into the new year.

In the long-term, BTS will continue to focus in areas where it has been successful in the past and will build on newly acquired expertise to branch out into additional adjacent markets.

### Backlog

The Company's backlog at September 30, 2010 was \$924 million with terms extending to fiscal 2018. This compares to \$873 million reported at the end of September 2009. Contracted Backlog represents maximum potential revenues remaining to be earned on signed contracts, whereas Option Renewals represent customers' options to further extend existing contracts under similar terms and conditions. Backlog is adjusted for work performed, new contract wins or extension options on new contracts, previous extension options exercised or lapsed, changes in revenue profiles, changes in customer utilization patterns or for changes in contract scope.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

During 2010 the following contracts were the major contributor to the increase in the Company's backlog. There were no contracts which were cancelled unexpectedly which resulted in a decrease in our backlog. These contracts are further described in the business overview section of this Management Discussion and Analysis.

- Royal Military College for \$60 million to December 31, 2015
- Canadian Defence Agency for \$65 million to May 31, 2015
- National Maintenance for DND for \$15 million to August 31, 2013
- European Space Agency for \$24 million - expected completion in mid 2012
- Canadian Space Agency for \$10 million - expected completion in mid 2012
- \$24 million in ongoing manufacturing orders from KDS, RIM, Ericsson and DRS

Most fee for service contracts provide the customer with the ability to adjust the timing and level of effort throughout the contract life and as such the amount actually realized could be materially different from the original contract value. The following table represents management's best estimate of the backlog realization for 2011, 2012 and beyond based on management's current visibility into customers' existing requirements.

Management's estimate of the realizable portion (current utilization rates and known customer requirements) is less than the total value of signed contracts and related options by approximately \$228 million. The majority of this amount relates to the health services support contract. The Company's policy is to reduce the reported contractual backlog once it receives confirmation from the customer that indicates the utilization of the full contract value may not materialize.

(dollars in millions)	Fiscal 2011	Fiscal 2012	Beyond 2012	Estimated realizable portion of Backlog	Excess over estimated realizable portion	TOTAL
Contracted Backlog	\$ 169	\$ 94	\$ 64	\$ 327	\$ 103	\$ 430
Option Renewals	12	52	305	369	125	494
<b>TOTAL</b>	<b>\$ 181</b>	<b>\$ 146</b>	<b>\$ 369</b>	<b>\$ 696</b>	<b>\$ 228</b>	<b>\$ 924</b>
Business and Technology Services	\$ 140	\$ 128	\$ 354	\$ 622	\$ 228	\$ 850
Systems Engineering	41	18	15	74	-	74
<b>TOTAL</b>	<b>\$ 181</b>	<b>\$ 146</b>	<b>\$ 369</b>	<b>\$ 696</b>	<b>\$ 228</b>	<b>\$ 924</b>

### Selected Annual Information

(dollars in millions, except per share data)

	2010	2009	2008
Revenues	\$ 215.7	\$ 227.2	\$ 193.2
Net earnings	\$ 13.6	\$ 16.5	\$ 10.5
Net earnings per share, basic	\$ 1.75	\$ 2.12	\$ 1.27
Net earnings per share, diluted	\$ 1.75	\$ 2.11	\$ 1.27
Total assets	\$ 91.9	\$ 104.3	\$ 85.9
Dividends per share	\$ 1.79	\$ 0.64	\$ 0.54

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## 2010 Results of Operations

Earnings before other income and expense, interest and income taxes were \$18,633 in 2010 compared with \$24,272 in 2009 and net earnings were \$13,610 for the year compared with \$16,452 in the previous year. The Company completed the year with \$29,055 of cash compared to \$43,662 at the end of 2009.

### Revenues

	2010	2009	% change
SED revenues	\$ 64,000	\$ 75,527	(15%)
BTS revenues	\$ 151,725	\$ 151,703	- %
Consolidated revenues	\$ 215,725	\$ 227,230	( 5%)

The general business environment in 2010 continued to be very competitive. The Company began the year with \$151 million of its backlog to be earned in 2010. This base of work combined with the win of several larger contracts during 2010 resulted in a solid revenue stream for the year.

SED saw continued stability in the satellite industry. However, as expected, revenues are back to more traditional levels of activity in both the satellite engineering and contract manufacturing sectors due to the completion or near-completion of several large contracts in 2009 and decreased demand in the custom manufacturing area. It should be noted that due to the project nature of its business, the SED division is susceptible to significant variation in volumes of activity from period to period.

BTS did not see any revenue growth this year. Although improvements were realized in some areas this year, belt-tightening by government departments, midway into the year, the completion of a certain contract and a slowdown in private sector staffing were the main contributors to the absence of revenue growth for the year.

The Company derives a significant portion of its revenues from the Government of Canada. During 2010 (2009), 64% (60%) of revenues were related to contracts with various departments and agencies of the Government of Canada with approximately 55% (55%) directly with DND. Both of the Company's divisions conduct business with the Government of Canada.

Management expects that the marketplace in 2011 will continue to be very competitive. The market conditions for SED are expected to be stable and present new opportunities in 2011 although the related timing continues to be somewhat uncertain. The level of manufacturing activity is expecting to be stable; however customer requirements are subject to change on short notice. With a solid level of activity on existing contracts heading into 2011 and new opportunities available in the marketplace, BTS revenue levels are expected to improve over the prior year. However, the timing of future contract awards will ultimately determine BTS revenues for the next 12 months. While the Company begins the year with \$181 million of backlog to be earned in 2011, the above noted variables will have an impact on revenues ultimately realized.

### Cost of revenues and Gross profit

	2010	2009	% change
SED gross profit	\$ 17,075	\$ 23,269	(27%)
As a percentage of SED revenues	26.7%	30.8%	
BTS gross profit	\$ 25,707	\$ 25,943	( 1%)
As a percentage of BTS revenues	16.9%	17.1%	
Consolidated gross profit	\$ 42,782	\$ 49,212	(13%)
As a percentage of consolidated revenues	19.8%	21.7%	

The Company's cost of revenues includes all direct costs incurred in the provision of its products and services. These costs include all expenses associated with direct full-time staff, contract staff and subcontractors. They also include other direct costs including the landed cost of hardware and software sold as components of a solution, travel and living expenses necessary in the delivery of the services, and provision for warranty where applicable.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

The consolidated gross margin for 2010 was affected by lower margins realized in both divisions and was also biased by the smaller proportion of SED revenues.

The above average gross margin at SED in 2009 was due to a combination of several positive factors. With increased activity in all components of its business, SED was able to achieve exceptional utilization resulting in economies of scale. In addition, the excellent project execution and retirement of risk on certain projects provided for additional margin as well. With the level of business for 2010 returning to more traditional levels, especially in the contract manufacturing sector, economies of scale achieved in the prior year could not be realized.

While the BTS gross margin was mostly in line with the prior year, the mix of business, and competitive pressures particularly in the private sector had a slight effect on overall margins.

Because of the significant difference in gross margin between each of the two divisions, the overall gross margin of the Company is dependent on the relative level of revenue generated from each division. Management will continue to focus on execution in order to maximize margins. Increased competition is expected to put downward pressure on future margins in both divisions. In addition, the continued volatility of the Canadian dollar coupled with lower utilization levels in the short term are expected to further dampen margins in the SED division.

### Selling and marketing

	2010	2009	% change
Selling and marketing	\$ 4,770	\$ 4,957	(4%)
As a percentage of consolidated revenues	2.2%	2.2%	

Selling and marketing expenses as a percentage of sales remain stable. Costs for 2011 are expected to remain relatively stable over the 2010 levels.

### General and administration

	2010	2009	% change
General and administration	\$ 15,310	\$ 15,714	
Write-off of Nortel receivable	-	(757)	
General and administration excluding Nortel	15,310	14,957	2.4%
As a percentage of consolidated revenues	7.1%	6.6%	

General and administration costs increased slightly in line with cost escalation factors. General and administration costs increased as a percentage of revenue as a result of a significant decrease in revenues in 2010 compared to 2009 with most costs not scalable on a short-term basis. Looking ahead, management believes that general and administration costs will remain mostly in line with activity levels. However, during 2011, BTS expects to increase its business excellence efforts by realigning its information systems and making further improvements in scalability; the foundation on which future operating costs will be controlled and the long-term competitiveness maintained and ultimately improved.

### Facilities

	2010	2009	% change
Facilities	\$ 3,105	\$ 3,230	(4%)

Facility expenses, which include costs associated with office space, have been relatively stable over the past several years. 2010 costs were slightly lower as minor repairs were required to certain leased facilities in 2009. Overall facility costs are not expected to increase significantly in 2011.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Depreciation and amortization

	2010	2009	% change
Depreciation and amortization	\$ 944	\$ 1,246	(24%)

The Company modified its depreciation policy in 2010 resulting in a favorable adjustment to its depreciation expense for the year. The Company does not require a significant amount of new capital every year.

### Interest income

Interest income is comprised of interest earned on the Company's cash balances and accrued interest related to the investment in AIM Health Group Inc. (AIM). Interest income earned on cash balances decreased to \$193 in 2010 from \$241 in 2009 as a result of a slight decrease in interest rates during 2010.

### Unrealized loss on fair value of conversion options of investment

The Company recorded a loss of \$52 for the year compared to a loss of \$220 in 2009 relating to the fair value of conversion options of long-term investment. The reported unrealized loss is a reflection of the movement in quoted market prices of AIM shares and the remaining option term.

### Loss on share exchange

On January 20, 2009, Med-Emerg announced that it successfully merged with AIM in an all-stock transaction. At that time, Calian surrendered its preferred shares in Med-Emerg in exchange for a secured convertible debenture of AIM with a face value of \$3,897. The share exchange resulted in a loss on exchange of \$125 in 2009.

### Prior year investment tax credits

During 2009 the Company recorded additional investment tax credits of \$311 with respect to its re-filing of its fiscal year 2006 R&D claims.

### Income tax expense

The Company reports its results on a fully taxed basis. The provision for income taxes for 2010 was \$5,724 or 29.6% of earnings before income taxes compared to \$8,190 or 33.2% of earnings before income taxes in 2009. The decrease in the effective tax rate for 2010 is mainly the result of a decrease in federal and provincial prescribed income tax rates and the positive impact of adjustments related to 2009. With prescribed federal and provincial tax rates continuing to decrease, the effective tax rate for 2011, prior to considering the impact of non-taxable transactions, is expected to be approximately 29%.

### Net earnings

The Company reported net earnings of \$13,610 or \$1.75 per share basic and diluted for 2010 compared to \$16,452 or \$2.12 per share basic and \$2.11 per share diluted in 2009.

### Selected Quarterly Financial Data

(dollars in millions, except per share data)

	Q4/10	Q3/10	Q2/10	Q1/10	Q4/09	Q3/09	Q2/09	Q1/09
Revenues	\$ 52.9	\$ 57.6	\$ 53.1	\$ 52.1	\$ 54.4	\$ 57.8	\$ 59.9	\$ 55.1
Net earnings	\$ 3.2	\$ 3.9	\$ 3.1	\$ 3.4	\$ 3.5	\$ 4.5	\$ 5.2	\$ 3.3
Net earnings per share								
Basic	\$ 0.42	\$ 0.49	\$ 0.40	\$ 0.44	\$ 0.45	\$ 0.58	\$ 0.67	\$ 0.42
Diluted	\$ 0.42	\$ 0.49	\$ 0.40	\$ 0.44	\$ 0.44	\$ 0.58	\$ 0.67	\$ 0.42

The Company's operations are subject to some quarterly seasonality due to the timing of vacation periods and statutory holidays. Typically the Company's first and last quarter will be negatively impacted as a result of the Christmas season and summer vacation period. During these periods, the Company can only invoice for work performed and is also required to

## Management's Discussion and Analysis of Financial Condition and Results of Operations

pay for statutory holidays. This results in reduced levels of revenues and a drop in gross margins. This seasonality may not be apparent in the overall results of the Company depending on the impact of the realized sales mix of its various projects.

The full text of the Company's fourth quarter management discussion and analysis can be found on SEDAR at [www.SEDAR.com](http://www.SEDAR.com).

### Liquidity and Capital Resources

Calian's net cash position was \$29,055 at September 30, 2010, compared to \$43,662 at September 30, 2009.

	2010	2009
Cash flows from operating activities before changes in working capital	\$ 14,656	\$ 18,615
Changes in working capital	(12,508)	7,440
Cash flows from operating activities	2,148	26,055
Cash flows used for financing activities	(15,330)	(8,412)
Cash flows used for investing activities	(1,378)	(1,392)
Currency translation	(47)	84
Increase (decrease) in cash	\$ (14,607)	\$ 16,335

### Operating activities

Cash inflows from operating activities for the year ending September 30, 2010 were \$2,148 compared to \$26,055 in 2009. This year's decrease is the result of lower earnings coupled with working capital fluctuations in line with the ebbs and flows of the business and a decrease in advance customer payments of \$9,029 compared to an increase of \$8,244 in the prior year. The market for the Systems Engineering Division is characterized by long-term contracts with billings tied to milestones achieved, which often results in significant working capital requirements. Conversely, given the nature of this business, it is sometimes possible to negotiate advance payments on contracts. Such advance payments give rise to unearned revenue that will be realized as revenue over the course of the contract. As at September 30, 2010, the Company's total unearned revenue amounted to \$11,763. This compares to \$20,792 one year earlier, with the decrease primarily attributable to work progressing on the third deep space antenna contract for ESA.

### Financing activities

#### Dividend

As a result of continuing earnings and a strong cash position, the Company once again increased its dividend in 2010. The Company paid quarterly dividends totaling \$6,138 or \$0.79 cents per share compared to 2009 when the Company paid \$4,970 in dividends or \$0.64 cents per share. In 2010, the Company also paid a special dividend of \$7,802 or \$1.00 per share. The Company intends to continue with its quarterly dividend policy for the foreseeable future.

#### Shares

During 2010, the Company repurchased 147,950 common shares at an average price of \$17.43 and during 2009 the Company repurchased 472,400 common shares at an average price of \$10.44 through its normal course issuer bids.

At September 30, 2010 there were 76,800 options outstanding at an average exercise price of \$11.71 expiring at various dates between February 4, 2012 and November 18, 2013.

At September 30, 2010 there were 7,706,895 common shares outstanding and as of the date of this Management Discussion and Analysis, there were 7,718,595 common shares outstanding.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Investing activities

### Equipment expenditures

Calian acquired \$1,378 in equipment, furniture and fixtures during 2010, compared to \$1,392 during 2009. During 2011 expenditures are expected to be in line with normal levels. At September 30, 2010 there were no significant commitments to expend capital assets.

### Capital resources

At September 30, 2010 the Company had a short-term credit facility of \$10,000 with a Canadian chartered bank that bears interest at prime and is secured by assets of the Company. An amount of \$612 was drawn to issue a letter of credit to meet customer contractual requirements. Management believes that the Company has sufficient cash resources to continue to finance its working capital requirements and pay a quarterly dividend.

### Contractual obligations

Payments due:	Total	<1 year	1-3 years	4-5 years	>5 years
Operating leases	\$ 12,278	\$ 2,414	\$ 4,378	\$ 4,179	1,307
Purchase obligations	12,678	7,747	4,931	-	-
Total contractual obligations	\$ 24,956	\$ 10,161	\$ 9,309	\$ 4,179	1,307

Purchase obligations include agreements to purchase goods and services that are enforceable and legally binding. They do not include agreements that are cancellable without penalty.

### Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements at September 30, 2010.

### Operating leases

The Company leases various premises and office equipment through operating leases.

### Related party transactions

There were no transactions with related parties during 2010 and 2009.

### Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the Company's financial condition and results of operations. On an on-going basis, management reviews its estimates and assumptions, including those related to revenue recognition on fixed-price projects, provisions and contingencies, estimated timing of reversals of income tax temporary differences, allowance for doubtful accounts, valuation of investment and impairment of goodwill. Management bases its estimates and assumptions on historical experience and on various other factors that it believes to be reasonable under the circumstances; actual results could differ from those estimates.

### Revenue recognition

The Business and Technology Services Division's revenue is derived primarily from per-diem contracts where revenue is recognized when the services are provided. However, a significant portion of the Systems Engineering Division's revenue is derived from fixed-price contracts. Revenue from these fixed-price projects is recognized using the percentage of completion method using management's best estimate of the costs and related risks associated with completing the projects. The greatest risk on fixed-price contracts is the possibility of cost overruns. Management's approach to revenue recognition is tightly linked to detailed project management processes and controls. The information provided by the project management system combined with a knowledgeable assessment of technical complexities and risks are used in estimating the percentage completion.

### Provisions

The Company provides warranties for systems delivered to its customers. A provision for warranty cost is recorded when revenue for the underlying system is recognized. The cost is estimated based on a number of factors, including historical warranty claims and cost experience, the type and duration of warranty coverage, the nature of the system delivered and the

## Management's Discussion and Analysis of Financial Condition and Results of Operations

counter-warranty coverage available from our suppliers. Warranty provisions are reviewed quarterly, and any adjustment is recognized to income. Warranty expense is recorded as a component of cost of sales.

### Contingencies

From time to time the Company is involved in claims in the normal course of business. Management assesses such claims and where considered likely to result in a material exposure and, where the amount of the claim is quantifiable, provisions for loss are made based on management's assessment of the likely outcome. The Company does not provide for claims that are considered unlikely to result in a significant loss, claims for which the outcome is not determinable or claims where the amount of the loss cannot be reasonably estimated. Any settlements or awards under such claims are provided for when reasonably determinable.

### Income taxes

The Company records future income tax assets and liabilities related to deductible temporary differences. The Company assesses the value of these assets and liabilities based on their realizability given management assessments of future taxable income.

### Allowance for doubtful accounts

The Company has extensive commercial history upon which to base its provision for doubtful accounts. Due to the nature of the industry in which the Company operates, the Company does not create a general provision for bad debts but rather determines bad debts on a specific account basis. Due to the blue-chip list of customers, the Company's allowance for doubtful accounts at September 30, 2010 and 2009 was minimal.

### Goodwill

Goodwill is tested for impairment annually or more frequently when events occur or circumstances arise that could indicate a reduction in its fair value. Testing for impairment is accomplished by determining whether the fair value of the reporting unit exceeds the net carrying value as of the assessment date. If the fair value is greater than the carrying amount, no impairment is necessary. The determination of fair value is based on management's estimate of future results of operations of the reporting unit using reasonable assumptions relating to growth levels when considering the current and forecasted business environment and the Company's weighted average cost of capital (WACC). For purposes of determining fair value, management considered a growth level range of 0% to 5% and a WACC range of 13% to 15%.

### Investment

As described in Note 6 of the Company's consolidated financial statement, the investment in AIM is reviewed for events or circumstances that indicate a credit loss was incurred. At September 30, 2010, there were no events indicating that a credit loss was incurred.

## Adoption of New Accounting Policies During The Year

For the year ended September 30, 2010, the Company adopted the following accounting policies.

### Equipment and Intangible Assets

Effective October 1, 2009, the Company modified its depreciation methodology from declining balance to straight-line depreciation, with amortization calculated over 5 to 10 years, to better reflect the estimated usage of the Company's equipment and intangible. The change did not have a material impact on the financial statements.

### Financial Instruments

Effective October 1, 2009, management adopted amended Section 3855, Financial Instruments - Recognition and Measurement. Based on the amendments, management has the choice of classifying the host contract portion of its investment in AIM as an Available-For-Sale asset or as a Loans and Receivables asset. Management chose to classify the host contract as a Loans and Receivable asset. Loans and Receivable assets are recognized at amortized cost. At October 1, 2009, the carrying amount of the investment was decreased by \$128 with a corresponding adjustment to Accumulated Other Comprehensive Income to return the investment to amortized cost.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

In June 2009, the CICA issued amendments to Section 3862, Financial Instruments - Disclosures. The amendments provide for additional disclosure requirements about fair value measurements of financial instruments and enhanced liquidity risk disclosure requirements for publicly accountable enterprises. In the first fiscal year of application, comparative information for the disclosures is not required. The amendments are effective for the Company's annual financial statement for the year ended September 30, 2010. The required disclosure is provided in Note 18.

### Impact of Accounting Pronouncements Not Yet Implemented

#### Business Combinations

In January 2009, the CICA issued Section 1582, Business Combinations, replacing Section 1581, Business Combinations. This new Section will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted although at this time the Company does not anticipate early adopting the standard. The Section establishes standards for the accounting for a business combination and is harmonized with IFRS. The Company does not anticipate that the adoption of the new standard will have a significant impact on the financial statements of the Company.

#### Consolidated Financial Statements

In January 2009, the CICA issued Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling Interests, which together replace Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted when early adopting Section 1582, Business Combinations. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company does not anticipate that the adoption of the new standards will have a significant impact on the financial statements of the Company.

#### Multiple Deliverable Revenue Arrangements

In December 2009, the CICA issued Emerging Issues Committee-175 Multiple Deliverable Revenue Arrangements. This new EIC will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted. The abstract addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. The Company does not anticipate that the adoption of the new standards will have a significant impact on the financial statements of the Company.

#### International Financial Reporting Standards

The Canadian Accounting Standards Board has announced that Canadian publicly accountable enterprises will be required to report under International Financial Reporting Standards (IFRS) as replacement guidance for Canadian generally accepted accounting principles (Canadian GAAP) effective for fiscal years beginning after January 1, 2010. Therefore, the Company will adopt IFRS as the basis of preparation for its interim and annual financial statements for periods beginning on October 1, 2011 with a transition date of October 1, 2010 to allow for comparative financial information.

IFRS uses a conceptual framework similar to current Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. In addition, it is expected that IFRS in effect at the time of reporting the Company's first IFRS financial statements will evolve from current IFRS and may result in additional differences. In order to prepare for the conversion to IFRS, the Company has developed an IFRS changeover plan. This plan addresses key elements of the Company's conversion to IFRS including:

- Accounting policy changes and financial reporting requirements;
- Education and training requirements;
- Impacts on business activities and on Information technology and data systems;
- Internal control over financial reporting
- Disclosure controls and procedures

We have also established a formal governance structure for the conversion to IFRS. The initiative is lead by the Chief Financial Officer who reports regularly to the Chief Executive Officer. The Chief Financial Officer also reports quarterly to the Audit Committee of the Board of Directors on the status of the project and the implications of the changeover to IFRS.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

During 2009, we completed the high-level diagnostic gap and impact analysis between Canadian GAAP and IFRS applicable to the Company including identifying significant technical accounting and disclosure differences, identifying key IFRS accounting policy alternatives and identifying major operational and systems impacts.

During 2010, the following activities were performed:

- A detailed assessment was substantially completed for all key standards and significant accounting policy choices including IFRS 1 elective exemption choices (see summary of key expected changes hereafter);
- The creation of a duplicate IFRS compliant environment to track all adjusting IFRS entries for the Company's opening balance sheet and throughout the Company's dual reporting period of October 1, 2010 to September 30, 2011;
- A detailed assessment was performed of required changes to internal controls. Management concluded that internal controls applicable to the Company's reporting process under Canadian GAAP are fundamentally the same as those required in the Company's IFRS reporting environment;
- A detailed assessment was performed and some required changes to disclosure controls and procedures were identified. Disclosure controls and procedures have been updated to include all data required for financial statement disclosures under IFRS.
- A detailed assessment has been completed of the impact of IFRS on key performance indicators and business activities such as compensation arrangements, hedging activities and risk management practices. No significant changes were required;
- A detailed assessment was performed of required changes to systems, processes and documentation. No significant changes were required;
- A complete IFRS financial statement model was built and reviewed by management and the board of directors;
- Data collection for the opening balance sheet is in progress; and
- Key finance employees responsible to carry out the IFRS conversion were provided with adequate training and resources throughout this process. The Company also held an IFRS information session with all members of the board of directors. The Audit Committee is also appraised quarterly on IFRS standards and policy choices available to the Company.

During 2011 the following activities will take place:

- Monitor standards to be issued by the IASB and provide related training on such;
- Assess the impact of new IASB standards on the Company's opening balance sheet and its financial position and results of operations throughout the conversion period;
- Complete the data collection and finalize the assessment of the impact of adopting IFRS. Data collection for each quarter in fiscal 2011 is intended to be performed shortly following the closing of each quarter under Canadian GAAP;
- Complete the necessary work required to quantify the impact of the changeover to IFRS on the Company's financial position and results of operations at the date of transition and affecting the comparative year 2011 and the first reporting year 2012;
- Prepare fiscal 2011 quarterly financial statements under IFRS standards, in preparation for reporting comparative information in 2012; the Company's first year of reporting under IFRS.

### Summary of expected changes

The International Accounting Standards Board (IASB) has a number of ongoing projects on its agenda. Management continues to monitor standards to be issued by the IASB, but we do not expect these standards to be mandatory for the Company's fiscal 2012 financial statements. The summary of key expected changes set out in the tables below was completed with the expectation that we will apply IFRS standards as currently written at our transition date. However, management will only make final decisions regarding early adoption of any new standards as they are issued by the IASB.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

IFRS 1 - First-Time Adoption of International Financial Reporting Standards generally requires that a first-time adopter apply IFRS accounting policies retrospectively to all periods presented in its first IFRS compliant financial statements. IFRS 1 also provides certain mandatory and optional exemptions to the full retrospective application. The significant optional exemptions applicable to the Company are as follows:

Exemption	Conclusions
Cumulative translation adjustment (CTA)	Management elected to eliminate all cumulative foreign exchange losses recorded in the CTA at transition. <b>Opening balance sheet:</b> An elimination of \$357 debit balance in the CTA with an offsetting decrease in retained earnings. No impact on total equity.
Equipment	Management elected not to report equipment, in its opening balance sheet on the transition date, using fair value as the deemed cost. Instead the Company will continue to report equipment and intangibles at historical cost. <b>Opening balance sheet:</b> No impact.
Share-based payment	Management elected not to apply IFRS2 to options granted and vested before the transition date. IFRS2 was applied to non-vested options. <b>Opening balance sheet:</b> Impact insignificant.
Business combinations	Under the exemption allowed by IFRS 1, management elected to apply the provisions of IFRS 3 - Business Combinations, prospectively from the date of transition. <b>Opening balance sheet:</b> No impact.

The following are some of the Company's key changes in accounting policies required under IFRS standards which could have a significant impact with respect to the recognition and measurement of certain balance sheet and income statement items. Unless indicated, all changes in accounting policy will be applied retrospectively.

Accounting policy	Key differences in accounting treatment	Potential key impacts
Impairment of long-lived assets	IFRS requires a one-step impairment test for identifying and measuring impairment, comparing an asset's carrying value to the higher of its value in use and fair value less cost to sell. Under Canadian GAAP, impairment is based on discounted cash flows only if the asset's undiscounted cash flows are below its carrying value.	<b>Opening balance sheet:</b> No impact is expected. Subsequent to transition: The one-step impairment test under IFRS may result in more frequent write-downs of assets.
Equipment	IFRS allows the option of measuring equipment using either an historical cost model or a revaluation model. Under Canadian GAAP, equipment was required to be recognized at historical cost.	Management will elect to measure its equipment at historical cost. <b>Opening balance sheet and subsequent to transition:</b> No impact
Provision and contingent liabilities	IFRS requires a provision to be recognized when it is probable (more likely than not) that an outflow of resources will be required to settle the obligation, while a higher threshold is used under Canadian GAAP. Other differences exist such as the determination of the best estimate where there is a range of equally possible outcomes (IFRS uses the mid-point of the range whereas Canadian GAAP uses the low end), and the requirement under IFRS for provisions to be discounted where material.	<b>Opening balance sheet:</b> Based upon management's initial assessment of the Company's provisions and contingencies, no additional provisions have been identified which are required to be recognized at October 1, 2010. <b>Subsequent to transition:</b> A review will be performed at each balance sheet date to determine if any new provisions should be recognized.



## Management's Discussion and Analysis of Financial Condition and Results of Operations

Accounting policy	Key differences in accounting treatment	Potential key impacts
Income taxes	Tax consequences of a transaction recorded in Other Comprehensive Income (OCI) or directly in equity in previous periods must be recorded in OCI or directly in equity (i.e. backward tracing) under IFRS. Under Canadian GAAP, all subsequent changes in deferred income taxes are recorded through earnings.	<b>Opening balance sheet:</b> No significant impact is expected. Subsequent to transition: The impact on earnings will depend on the extent of changes in deferred income taxes that will be recorded in OCI or directly in equity.
Hedging	Under IFRS, management will assess the effectiveness of hedge relationships quantitatively. Hedge ineffectiveness will be recognized in net income. Under Canadian GAAP, a quantitative assessment is not required if certain specific criteria are met (known as the critical-terms match).	<b>Opening balance sheet:</b> No significant impact is expected. Subsequent to transition: The impact on earnings is not expected to be significant.
Financial instrument presentation	IFRS stipulates that an obligation is created when an agreement is entered into with a third party which provides for automatic repurchases of the Company's shares without the Company having the ability to influence the purchases. The financial liability is determined as the present value of the maximum redemption amount.	<b>Opening balance sheet:</b> A reclassification of \$179 and \$1,135 debit balance in the share capital and retained earnings accounts respectively with an offsetting adjustment to a share repurchase liability account. <b>Subsequent to transition:</b> An income adjustment will result on any share repurchased below the maximum amount per share. Based on historical trends, the amount of income to recognize is not expected to be significant.
Presentation and disclosure	IFRS minimum classification and presentation is different than Canadian GAAP.	<b>Opening balance sheet and subsequent to transition:</b> The format of the balance sheet and profit and loss statement will change to reflect the required classification and presentation.
Statement of cash flows	IFRS allows the option of presenting the statement of cash flow using either the direct method or indirect method.	Management will elect to present its Statement of cash flow using the indirect method. <b>Opening balance sheet and subsequent to transition:</b> No impact is expected.

The differences identified in this document should not be regarded as an exhaustive list and other changes may result from the Company's conversion to IFRS. Furthermore, the disclosed impacts reflect our most recent assumptions, estimates and expectations. As a result of changes in circumstances, such as economic conditions or operations, and the inherent uncertainty from the use of assumptions, the actual impacts may be different from those presented above.

### Management's Conclusion on the Effectiveness of Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer of the Company, after evaluating the effectiveness of the Company's disclosure controls and procedures as of September 30, 2010, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries would have been known to them and that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified in the securities legislation.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Management's Conclusion on the Effectiveness of Internal Control over Financial Reporting

The Chief Executive Officer and the Chief Financial Officer of the Company, after evaluating the effectiveness of the Company's internal control over financial reporting as of September 30, 2010, have concluded that the Company's internal controls over financial reporting provide reasonable assurance regarding the reliability of financial reporting for external purposes in accordance with Canadian GAAP.

During the most recent interim quarter ending September 30, 2010, there have been no changes in the design of the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

## Risk Factors

The Company is subject to a number of risks and uncertainties that could significantly affect the Company's financial condition and future results of operations. Risk management is an integral part of how the Company plans and monitors the business strategies and results and we have embedded risk management activities in the operational responsibilities of management and made them an integral part of our overall governance, organizational and accountability structure. The Systems Engineering and Business and Technology Services divisions face some or all of the following risks and uncertainties:

### Competition for contracts within key markets

The markets for the Company's services are intensely competitive, rapidly evolving and subject to technological changes. The principal competitive factors in the Company's markets are quality, performance, price, timeliness, customer support and reputation. The Company has a disciplined approach to management of all aspects of its business. The Company is a proponent of quality management; SED is registered under ISO 9001-2008 standards and BTS is accredited at Level 4 of the Progressive Excellence Program by the National Quality Institute. This approach to management was developed to help the Company ensure that its employees deliver services consistently according to the Company's high standards and based on strong values underlying its client-focused culture.

### The availability of qualified professionals

Competition from other firms has a two-fold impact on the Company. The Company must not only vie for qualified employees for its own operations but must have ready access to a large pool of qualified professionals to satisfy contractual arrangements with customers. The Company mitigates these factors through a number of means. The Company's performance driven remuneration policies and its favorable working environment are conducive to attracting ambitious, qualified professionals. As a supplier of professional employees through outsourcing contracts, the Company regularly establishes relationships with a significant number of professionals in key markets.

### Performance on fixed-price contracts

A large percentage of SED's contracts are based on a fixed price for the provision of a specified service or system against an agreed delivery schedule. These fixed-price contracts at times involve the completion of large-scale system engineering projects. There is a risk in all fixed-price contracts that the Company will be unable to deliver the system within the time specified and at the expected cost. The Company employs sophisticated design and testing processes and practices, which include a wide range of stringent factory and on-site acceptance tests with criteria and requirements jointly developed with the customer. However, non-performance could result in a customer being in a position to terminate the contract for default, or to demand repayments or penalties. Program management methodologies have been implemented to adequately manage each project and any customer change, and to identify and mitigate potential technical risks and related cost overruns. In addition, the Company employs procedures to ensure accurate estimating of costs and performs regular detailed reviews of progress on each project.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### **Non-performance of a key supplier or contractor**

The Company's business is often dependent on performance by third parties and subcontractors for completion of contracts for which the Company is the prime contractor. Subcontractors for large systems are selected in concurrence with the customer's requirements, and if not directed by the customer, are selected through a competitive bid or negotiated process. Most major development subcontracts are established as fixed-price contracts. The Company believes that these subcontractors have an economic incentive to perform such subcontracts for the Company. However, no company can protect itself against all material breaches, particularly those related to financial insolvency of the subcontractors or to cost overruns by subcontractors. Risks include a significant price increase in those few subcontracts that are not fixed-price, delay in performance, failure of any major subcontractor to perform or the inability of the Company to obtain replacement subcontractors at a reasonable price. The performance of key subcontracts is closely monitored as part of the Company's project management process to promptly identify potential issues and develop remedial actions.

### **Rapidly changing technologies and customer demands**

The markets in which the Company operates are characterized by changing technology and evolving industry standards. The Company keeps pace with developments in the industries it serves and actively monitors the evolution of these markets, thus ensuring that it can meet the evolving needs of its clients. The Company achieves this by continually recruiting professionals in high demand positions and providing regular training to ensure employee skills remain current. The Company's ability to anticipate changes in technology, technical standards and service offerings will be a significant factor in the Company's ability to compete or expand into new markets.

### **Government contracts**

During 2010, approximately 64% of the Company's total revenues were derived from contracts with the Canadian government and its agencies. The government may change its policies, priorities or funding levels through agency or program budget reductions or impose budgetary constraints. Furthermore, contracts with governments, including the Canadian government, may be terminated or suspended by the government at any time, with or without cause. Although in the past the Company has not experienced any significant cancellations of previously awarded contracts by the Canadian government, there can be no assurance that any contract with the government will not be terminated or suspended in the future.

### **Backlog**

Most fee for service contracts provide the customer with the ability to adjust the timing and level of effort throughout the contract life and as such the amount actually realized could be materially different from the original contract value. At September 30, 2010 the Company's backlog included \$228 million of contract value in excess of the current estimated utilization levels. Should additional customer requirements for the Company's services under these contracts not materialize, this excess will not be realized.

### **Credit risk concentration with respect to accounts receivable**

As the Company grows, it monitors the concentration of its business in its various segments and with particular customers. In management's opinion, the fact that the Company operates in two segments that provide some diversification of its customer base mitigates the potential impact on earnings and cash flow of problems related to an individual sector or customer.

### **Insufficient or inappropriate mix of work for fixed labour resources**

Virtually all employees of SED are full time staff and represent a broad spectrum of unique skill sets. Accordingly, SED strives to secure sufficient labour sales that adequately match the skill sets. SED's business development practices are designed to dynamically adjust pursuits of contracts to address the sufficiency and mix of available resources.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## **Operational risk**

Operational risk is managed through the establishment of effective infrastructure and controls. Key elements of the infrastructure are qualified, well-trained personnel, clear authorization levels and reliable technology. Controls established by documented policies and procedures include the regular examination of internal controls by internal employees as well as our auditors, segregation of duties, and financial management and reporting. In addition, the Company maintains insurance coverage and contingency plans for systems failures or catastrophic events.

## **Foreign currency risk**

The Company operates internationally with approximately 23% of its business derived from non-Canadian sources. A substantial portion of this international business is denominated in major foreign currencies and therefore the Company's results from operations are affected by exchange rate fluctuations of these currencies relative to the Canadian dollar. The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. At September 30, 2010 the Company had various forward exchange contracts, which are explained in Note 18 to the Company's consolidated financial statements for the year ended September 30, 2010. The strengthening of the Canadian dollar relative to other foreign currencies may negatively impact the Company's competitiveness and increase pressure on margins for new work.

## **Sufficiency of insurance**

The Company carries various forms of insurance to protect itself from a variety of insurable risks. However, such coverage may not be sufficient in extreme circumstances and accordingly there exists a risk to the Company. While the Company cannot reasonably insure itself for all events, it regularly reviews the availability, scope and amounts of coverage with its professional advisors and implements an approach balancing both cost and risk.

## **Medical malpractice**

As a result of the Company executing the health services support contract for the Department of National Defence, the Company is subject to risks associated with the medical profession. In order to mitigate such risks to the degree possible, the Company has obtained medical malpractice and professional liability insurance in accordance with the terms of this contract. In addition, it is a condition of employment for doctors, dentists and other medical professionals to maintain appropriate credentials, be in good standing with their medical associations and obtain medical malpractice insurance from their respective association.

## **Political and trade barriers**

Revenues on certain projects are derived from customers in foreign jurisdictions and are subject to trade and political barriers relating to the protection of national interests. These barriers could have an adverse effect on our ability to win repeat business and attract new customers.

## **Consolidation of customer base**

The satellite industry has experienced both restructuring and consolidation. As the newly formed entities focus on optimizing cash flows and gaining economies of scale, opportunities for systems integrators may be diminished thereby creating a very competitive environment with commensurate pressure on margins.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Long-term Outlook

Management believes the Company is well positioned for long-term sustained growth. The Company operates in markets that will continue to require the services that the Company offers. To further assure itself of a stable source of revenues, the Company will focus on increasing the percentage of its revenues derived from recurring business while pursuing new business in adjacent markets.

The Systems Engineering Division has been working within a stable satellite sector for the last two years and the division is expecting new opportunities to arise as systems adopting the latest technologies will be required by customers to maintain and improve their service offerings. Management is also confident that systems such as MSTAR will continue to be in demand in the security and surveillance market although it cannot predict the timing and extent of future orders. Custom manufacturing activity levels will continue to be directly dependant upon SED's customers' requirements. The continued volatility of the Canadian dollar could impact the Systems Engineering Division's competitiveness when bidding against foreign competition on projects denominated in foreign currencies.

The Business and Technology Services Division's services are adaptable to many different markets. Currently, its strength lies in providing program management and delivery services to the Department of National Defence. Management believes that this department and many others within the federal government will continue to require more support services from private enterprises to supplement their current workforce. Management believes that the types of service the division offers will continue to be attractive to government agencies going forward.

## Additional Information

Additional information about the Company such as the Company's 2010 Annual Information Form and Management Circular can be found on SEDAR at [www.SEDAR.com](http://www.SEDAR.com)

Dated: December 3, 2010

## Management's Statement of Responsibility

The accompanying consolidated financial statements of Calian Technologies Ltd. and its subsidiaries and all information in the annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements include some amounts that are based on management's best estimates that have been made using careful judgment.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

In fulfilling its responsibilities, management of Calian and its subsidiaries has developed and continues to maintain systems of internal accounting controls including written policies and procedures and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded and the financial records are reliable for preparing the financial statements.

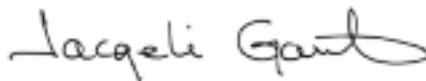
The Board of Directors carries out its responsibility for the financial statements in this report through its Audit Committee. The Audit Committee meets periodically with management to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the financial statements and financial reporting matters. The Audit Committee also meets periodically with the external auditors to review and discuss the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who have full access to the Audit Committee with and without the presence of management.



**Ray Basler**

*President and CEO  
Ottawa, Ontario  
November 9, 2010*



**Jacqueline Gauthier**

*Chief Financial Officer*

## Auditors' Report

To the Shareholders of Calian Technologies Ltd.

We have audited the consolidated balance sheets of Calian Technologies Ltd. as at September 30, 2010 and 2009 and the consolidated statements of earnings and retained earnings, cash flows, comprehensive income and accumulated other comprehensive income (loss) and retained earnings for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



**Chartered Accountants  
Licensed Public Accountants**

*Ottawa, Ontario  
November 9, 2010*

**Calian Technologies Ltd.**  
**Consolidated Statements of Earnings and Retained Earnings**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

	<b>2010</b>	<b>2009</b>
Revenues	\$ 215,725	\$ 227,230
Cost of revenues	172,943	178,018
Gross profit	42,782	49,212
Selling and marketing	4,770	4,957
General and administration	15,310	15,714
Facilities	3,105	3,230
Stock option compensation (Note 10)	20	104
Depreciation and amortization	944	1,246
Prior year investment tax credits (Note 5)	-	(311)
Earnings before other expense, interest income and income tax expense	18,633	24,272
Unrealized loss on fair value of conversion options of investment (Note 6)	(52)	(220)
Loss on share exchange (Note 6)	-	(125)
Interest income (Note 12)	753	715
Earnings before income tax expense	19,334	24,642
Income tax expense (Note 5):		
Current	5,195	8,055
Future	529	135
	5,724	8,190
<b>NET EARNINGS</b>	<b>\$ 13,610</b>	<b>\$ 16,452</b>
Retained earnings, beginning of year	42,692	35,148
Excess of purchase price over stated capital on repurchase of shares (Note 9)	(2,226)	(3,938)
Dividends	(13,940)	(4,970)
Retained earnings, end of year	\$ 40,136	\$ 42,692
Net earnings per share (Note 11)		
Basic	\$ 1.75	\$ 2.12
Diluted	\$ 1.75	\$ 2.11
Weighted average number of shares (Note 11)		
Basic	7,756,584	7,764,119
Diluted	7,790,825	7,814,984

*The accompanying notes are an integral part of the consolidated financial statements.*

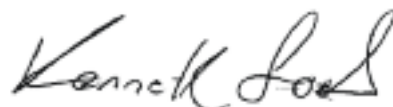


**Calian Technologies Ltd.**  
**Consolidated Balance Sheets**  
**As at September 30, 2010 and 2009**  
(Canadian dollars in thousands)

	2010	2009
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 29,055	\$ 43,662
Accounts receivable	33,954	32,816
Work in process	3,576	2,766
Prepaid expenses (Note 4)	6,329	5,656
Future income taxes (Note 5)	696	1,472
Derivative assets (Note 18)	158	679
Investment (Note 6)	953	-
	74,721	87,051
INVESTMENT (Note 6)	2,464	3,037
EQUIPMENT (Note 7)	4,611	4,300
INTANGIBLES (Note 8)	543	420
GOODWILL	9,518	9,518
	\$ 91,857	\$ 104,326
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 20,896	\$ 22,644
Unearned contract revenue	11,763	20,792
Derivative liabilities (Note 18)	48	377
	32,707	43,813
<b>COMMITMENTS (Note 13) AND CONTINGENCIES (Note 14)</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	18,689	17,719
Contributed surplus (Note 9)	171	285
Retained earnings	40,136	42,692
Accumulated other comprehensive income (loss)	154	(183)
	59,150	60,513
	\$ 91,857	\$ 104,326

*The accompanying notes are an integral part of the consolidated financial statements.*

Approved by the Board:



**Kenneth Loeb**  
*Chairman*



**Richard Vickers**  
*Director*

**Calian Technologies Ltd.**  
**Consolidated Statements of Comprehensive Income**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands)

	<b>2010</b>	<b>2009</b>
Net earnings	\$ 13,610	\$ 16,452
Unrealized gain (loss) on translating financial statements of self-sustaining foreign operation, net of tax of nil	(47)	84
Unrealized loss on fair value of host contract component of investment, net of tax of nil	-	(257)
Change in deferred gain on derivatives designated as cash flow hedges, net of tax of \$246 (2009: \$450)	512	937
Other comprehensive income	465	764
Comprehensive income	\$ 14,075	\$ 17,216

**Calian Technologies Ltd.**  
**Consolidated Statements of Accumulated Other Comprehensive Income (Loss)**  
**and Retained Earnings**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands)

	<b>2010</b>	<b>2009</b>
Unrealized cumulative loss on translating financial statements of self-sustaining foreign operation, net of tax	\$ (357)	\$ (310)
Unrealized cumulative gain on fair value of host contract component of investment, net of tax (Note 2)	-	128
Deferred gain (loss) on derivatives designated as cash flow hedges, net of tax	511	(1)
Accumulated other comprehensive income (loss), end of year	154	(183)
Retained earnings, end of year	40,136	42,692
Accumulated other comprehensive income (loss) and retained earnings, end of year	\$ 40,290	\$ 42,509

*The accompanying notes are an integral part of the consolidated financial statements.*

**Calian Technologies Ltd.**  
**Consolidated Statements of Cash Flows**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands)

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net earnings	\$ 13,610	\$ 16,452
Items not affecting cash		
Interest accreted on host contract component of investment (Note 12)	(560)	(474)
Employee stock purchase plan compensation expense (Note 9)	61	50
Stock option compensation (Note 10)	20	104
Write-off of Nortel receivable	-	757
Depreciation and amortization	944	1,246
Future income tax expense (Note 5)	529	135
Unrealized loss on fair value of conversion options of investment (Note 6)	52	220
Loss on share exchange (Note 6)	-	125
	14,656	18,615
Change in non-cash working capital		
Accounts receivable	(996)	(758)
Work in process	(810)	1,996
Prepaid expenses (Note 4)	(673)	(4,954)
Accounts payable and accrued liabilities	(1,000)	2,932
Unearned contract revenue	(9,029)	8,224
	2,148	26,055
<b>CASH FLOWS USED IN FINANCING ACTIVITIES</b>		
Issuance of common shares (Note 10)	1,188	1,491
Dividends	(13,940)	(4,970)
Repurchase of shares (Note 9)	(2,578)	(4,933)
	(15,330)	(8,412)
<b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>		
Equipment and intangible expenditures	(1,378)	(1,392)
	(1,378)	(1,392)
<b>FOREIGN CURRENCY ADJUSTMENT</b>		
	(47)	84
<b>NET CASH INFLOW (OUTFLOW)</b>	<b>(14,607)</b>	<b>16,335</b>
<b>CASH, BEGINNING OF YEAR</b>	<b>43,662</b>	<b>27,327</b>
<b>CASH, END OF YEAR</b>	<b>\$ 29,055</b>	<b>\$ 43,662</b>
<b>SUPPLEMENTARY INFORMATION:</b>		
Income taxes paid	\$ 5,973	\$ 8,045

*The accompanying notes are an integral part of the consolidated financial statements.*

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

## **1. Nature of Operations**

Calian Technologies Ltd. ("the Company"), incorporated under the Canada Business Corporations Act, and its wholly-owned subsidiaries provide technology services to industry and government.

## **2. Accounting Policies**

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

### **Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Calian Ltd. and Calian Technology (U.S.) Ltd. All transactions and balances between these companies have been eliminated on consolidation.

### **Use of estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires the Company's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Significant areas requiring the use of estimates relate to the determination of percentage of completion, estimated project costs and revenues for contract revenue recognition, provisions and contingencies, estimated timing of reversals of income tax temporary differences, allowance for doubtful accounts, valuation of investment and the impairment of goodwill. Actual results could differ from those estimates.

Effective October 1, 2009, the Company modified its depreciation methodology from declining balance to straight-line depreciation, with amortization calculated over 5 to 10 years, to better reflect the estimated usage of the Company's equipment and intangible assets. The change did not have a material impact on the financial statements.

### **Revenue recognition**

Revenue on fixed-price contracts is recognized at the net realizable value of services provided using the percentage of completion method based on management estimates of costs to complete each contract. Billings and cash receipts in advance of amounts earned are reflected as unearned contract revenue. Provision is made for the entire amount of any expected losses on revenue contracts, if any, in the period in which they are first determinable. In addition, a provision for warranty claims is established when revenue is recognized, based on warranty terms and prior claim experience. As some contracts extend over one or more years, any revision in cost and profit estimates made during the course of the work are reflected in the accounting period in which the facts indicating a need for the revision become known.

Revenue derived from per-diem contracts is recognized in the period the services are provided.

### **Research and development costs and related investment tax credits**

Research costs are expensed in the period incurred. Development costs are expensed in the period incurred unless the Company believes a development project meets generally accepted criteria for deferral and amortization. No such costs have been deferred at September 30, 2010 and 2009.

Research and development costs incurred under contract are included in cost of sales net of related government assistance. Investment tax credits are accounted for using the cost reduction method, whereby the benefit is recognized as a reduction in the cost of the related asset or expenditure when there is reasonable assurance the tax credits will be realized and if it is more likely than not that they will be utilized to reduce taxes payable.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

## **2. Accounting Policies (Continued)**

### **Share-based compensation**

The Company has a stock option plan for executives and other key employees and an employee share purchase plan. The Company measures and recognizes compensation expense based on the fair-value of the stock or stock options issued using the Black-Scholes pricing model. The offsetting credit is recorded against contributed surplus.

Consideration paid by employees on the purchase of shares or exercise of options and related amounts of contributed surplus are recorded as share capital when the shares are issued.

### **Current monetary assets and liabilities**

Cash is measured at fair value with changes in fair value recorded in net income. Accounts receivable and accounts payable and accrued liabilities are measured at amortized cost with interest accretion recorded in net income. Due to the short-term nature of these assets and liabilities, the carrying amounts approximate fair value.

### **Work in process**

Work in process represents work performed but not invoiced and is recorded at net realizable value.

### **Investment**

The Company's investment is considered a hybrid instrument as it includes rights of conversion to common shares. The conversion options are considered to be embedded derivatives to be separated and valued independently of the underlying debenture investment "host contract". The conversion options are measured at fair value using a Black-Scholes model with changes in fair value recorded in net income. Effective October 1, 2009, management adopted amended Section 3855, Financial Instruments - Recognition and Measurement. Based on the amendments, management has the choice of classifying the host contract portion of its investment in AIM Healthcare Group (AIM) as an Available-For-Sale asset or as a Loans and Receivables asset. Management chose to classify the host contract as a Loans and Receivable asset. Loans and Receivable assets are recognized at amortized cost. At October 1, 2009, the carrying amount of the investment was decreased by \$128 with a corresponding adjustment to Accumulated Other Comprehensive Income to return the investment to amortized cost. The effective interest method is used to calculate interest income on the host contract. The carrying amount of the investment is equal to the sum of the fair value of the embedded derivative and the amortized cost of the host contract.

### **Income taxes**

The Company accounts for income taxes using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities using rates enacted or substantively enacted.

### **Equipment**

Equipment, comprising computer equipment, furniture and leasehold improvements, is recorded at cost, net of related government assistance and investment tax credits. Computer equipment is amortized on a straight-line basis over its estimated useful life not exceeding five years. Furniture is amortized on a straight-line basis over its estimated useful life not exceeding ten years. Leasehold improvements are amortized on a straight-line basis over the term of the leases. The Company's policy is to review all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when the carrying value of the asset exceeds the total undiscounted cash flows expected from its use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

## **2. Accounting Policies (Continued)**

### **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of net assets of acquired businesses. Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. When the carrying amount of a reporting unit's goodwill exceeds its fair value, an impairment loss is recognized in an amount equal to the excess. An impairment charge is recorded for goodwill that is considered impaired. The Company performs its annual review of goodwill on September 30th each year. Based on the impairment tests performed at September 30, 2010 and 2009, the Company concluded that a goodwill impairment charge was not required.

### **Intangibles**

Intangibles are comprised of application software used by the Company for general and administration purposes and for various customer related projects. Application software is amortized on a straight-line basis over its estimated useful life not exceeding five years. The amortization method and estimate of useful life is reviewed annually. The Company's policy is to review all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when the carrying value of the intangibles exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

### **Foreign currency translation**

Accounts denominated in foreign currencies have been translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities are translated at the rate of exchange in effect at year-end. Non-monetary items are translated at rates in effect on the dates of the transactions. Revenues and expenses are translated at rates in effect during the year except for amortization, which is translated at the same rate as the assets to which it relates. Gains and losses from translation are included in earnings in the period in which they occur.

The accounts of a wholly-owned subsidiary, which is considered to be a self-sustaining foreign operation, have been translated into Canadian dollars using the current rate method of foreign currency translation. Under this method, assets and liabilities are translated at the rate of exchange in effect at year-end. Revenues and expenses are translated at rates in effect during the year. Translation gains and losses are recorded in the cumulative translation adjustment as a separate component of other comprehensive income.

### **Financial instruments and risk management**

The Company utilizes derivative financial instruments in the management of its foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes. The Company applies hedge accounting when appropriate documentation and effectiveness criteria are met.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific contractually related firm commitments on projects. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Derivatives are recorded on the balance sheet at fair value with changes in fair value recorded in net income unless the derivative is designated as a cash flow hedge. Fair value of the forward exchange contracts reflects the cash flows due to or from the Company if settlement had taken place at the end of the period. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is recorded in other comprehensive income and is recognized in net income when the hedged item affects net income. The Company expenses transaction costs related to its foreign exchange contracts.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

## **2. Accounting Policies (Continued)**

### **Financial Instruments – Disclosures and Presentation**

Financial instrument classification is as follows:

Cash	Held for trading
Accounts receivable	Loans and receivables
Derivative assets and liabilities	Held for trading
Long-term investment – conversion option	Held for trading
Long-term investment – host contract	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

#### **Held for trading**

Held for trading financial assets and liabilities are typically acquired for resale, derivatives or other financial assets and liabilities that are designated as held for trading. They are measured at fair value with changes in fair value flowing through income in the period.

#### **Available-for-sale**

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale, or that are not classified as loans and receivables, held-to-maturity or held-for-trading investments. Available-for-sale financial assets are carried at fair value with unrealized gains and losses included in accumulated other comprehensive income until realized, when the cumulative gain or loss is transferred to other income.

#### **Loans and receivables**

Loans and receivables are recorded initially at fair value then are accounted for at amortized cost using the effective interest method.

#### **Other liabilities**

Other liabilities are recorded initially at fair value then accounted for at amortized cost using the effective interest method and include all financial liabilities, other than derivative instruments.

#### **Effective interest method**

The Company uses the effective interest method to recognize interest income or expense which includes transaction costs or fees, premiums or discounts earned or incurred.

#### **Comprehensive income**

Comprehensive income includes net earnings and other comprehensive income (OCI). OCI refers to changes in net assets from certain transactions and other events and circumstances, other than transactions with shareholders. These changes are recorded directly as a separate component of shareholders' equity and excluded from net earnings. The Company's OCI includes the foreign currency translation adjustment for its US subsidiary that does not use the Canadian dollar as its measurement currency and the change in fair value on the effective portion of derivatives designated as cash flow hedges where the hedged item has not yet been recognized in income.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

### **3. New accounting pronouncement**

#### **Financial Instruments**

In June 2009, the CICA issued amendments to Section 3862, Financial Instruments - Disclosures. The amendments provide for additional disclosure requirements about fair value measurements of financial instruments and enhanced liquidity risk disclosure requirements for publicly accountable enterprises. In the first fiscal year of application, comparative information for the disclosures is not required. The amendments are effective for the Company's annual financial statement for the year ended September 30, 2010. The required disclosure is provided in Note 18.

#### **Business Combinations**

In January 2009, the CICA issued Section 1582, Business Combinations, replacing Section 1581, Business Combinations. This new Section will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted although at this time the Company does not anticipate early adopting the standard. The Section establishes standards for the accounting for a business combination and is harmonized with IFRS. The Company does not anticipate that the adoption of the new standard will have a significant impact on the financial statements of the Company.

#### **Consolidated Financial Statements**

In January 2009, the CICA issued Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling Interests, which together replace Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted when early adopting Section 1582, Business Combinations. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company does not anticipate that the adoption of the new standards will have a significant impact on the financial statements of the Company.

#### **Multiple Deliverable Revenue Arrangements**

In December 2009, the CICA issued Emerging Issues Committee-175 Multiple Deliverable Revenue Arrangements. This new EIC will be applicable to financial statements relating to the Company's annual financial statements beginning on October 1, 2011. Earlier adoption is permitted. The abstract addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. The Company does not anticipate that the adoption of the new standards will have a significant impact on the financial statements of the Company.

#### **International Financial Reporting Standards**

Canadian public companies will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board. This change will be applicable to financial statements relating to the Company's annual financial statements beginning on or after October 1, 2011.



**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**4. Prepaid Expenses**

	2010	2009
Prepaid operating expenses	\$ 705	\$ 635
Milestone advance to subcontractor	5,624	5,021
	\$ 6,329	\$ 5,656

**5. Income Taxes**

The following table reconciles the difference between the income taxes that would result solely by applying statutory tax rates to pre-tax income and the income taxes actually provided in the accounts:

	2010	2009
Earnings before income taxes	\$ 19,334	\$ 24,642
Tax provision at the combined basic Canadian federal and provincial income tax rate of 31.4% (2009: 32.6%)	6,067	8,031
Increase resulting from:		
Permanent differences	(101)	43
Impact of rate reductions on valuation of future income tax assets	74	38
Other	(316)	78
Income tax expense	\$ 5,724	\$ 8,190

During 2009, the Company received an assessment from the Canada Revenue Agency regarding the Company's re-filing of its 2006 scientific research and experimental development (R&D) claim allowing additional R&D costs to be claimed. As a result the Company received a refund of \$311 of investment tax credits related to its 2006 R&D activities.

The balances of future income tax assets at September 30, 2010 and 2009 represent the future benefits of temporary differences between the tax and accounting bases of assets and liabilities, consisting mainly of amounts expensed for accounting purposes in advance of tax. None of the goodwill is expected to be deductible for tax purposes.

**6. Investment**

On July 11, 2006, the Company invested \$3,623 in Med-Emerg International Inc. (Med-Emerg) in the form of convertible preferred shares which included \$116 of acquisition costs. On January 20, 2009, Med-Emerg announced that it successfully merged with AIM Health Group Inc. (AIM) in an all-stock transaction. At that time, the Company surrendered its preferred shares in Med-Emerg in exchange for a secured convertible debenture of AIM with a face value of \$3,897. The share exchange resulted in a loss on exchange of \$125.

The non-interest bearing debenture is convertible into 6,831,372 common shares of AIM at the Company's option. AIM is also entitled to cause the debenture to be converted into common shares when in any given 6-month period, trading volumes of AIM common shares exceed 1,089,642 shares and the weighted average share price is at least \$0.57. Conversion is limited to 50% of the debenture in any 6-month period. On a fully converted basis, this investment represents a 6% interest based on the current number of common shares outstanding. The debenture is subordinated to secured creditors of record on January 20, 2009 and any bank indebtedness. The debenture is due to be redeemed in two instalments; \$1,000 payable in cash on January 1, 2011 and the remaining \$2,897 payable on July 11, 2011 in cash or AIM common shares at the option of AIM based on the then fair market value of the common shares.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**6. Investment (Continued)**

Fair value of investment:

	2010	2009
Med-Emerg investment, at cost	\$ 3,623	\$ 3,623
Med-Emerg cumulative unrealized gain on conversion options	(1,878)	(1,878)
Med-Emerg cumulative interest accretion on host contract	897	897
Med-Emerg fair value of investment on January 20, 2009, prior to exchange loss on share exchange	\$ 2,642 (125)	\$ 2,642 (125)
AIM investment, at cost	\$ 2,517	\$ 2,517
AIM cumulative unrealized gain (loss) on conversion options	(17)	35
AIM cumulative interest accretion on host contract	917	357
AIM cumulative unrealized gain on fair value of host contract component	-	128
Carrying value of AIM investment at September 30	\$ 3,417	\$ 3,037
Short-term portion	953	-
Long-term portion	\$ 2,464	\$ 3,037

The Company's investment is considered a hybrid instrument as it includes rights of conversion to common shares. The conversion options are considered to be embedded derivatives to be separated and valued independent of the underlying host contract.

The conversion options are measured at fair value with changes in fair value recorded in net income. During 2010 and 2009, the value of the options decreased resulting in an unrealized loss of \$52 and \$220 respectively. AIM shares are traded on the TSX Venture Exchange and currently trade in limited volume. The fair value of the conversion options applies the following data and assumptions to the Black-Scholes option pricing model:

AIM 30 days weighted average share price	\$ 0.12
Risk free interest rate	1.00%
Actual stock price volatility	76%
Expected life of options	0.75 years

**7. Equipment**

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Leasehold improvements	\$ 1,478	\$ 340	\$ 1,138	\$ 1,474	\$ 182	\$ 1,292
Equipment and furniture	9,546	6,073	3,473	8,890	5,882	3,008
	\$ 11,024	\$ 6,413	\$ 4,611	\$ 10,364	\$ 6,064	\$ 4,300

**8. Intangibles**

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Application software	\$ 2,195	\$ 1,652	\$ 543	\$ 1,794	\$ 1,374	\$ 420

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**9. Share Capital and Contributed Surplus**

Authorized: Unlimited number of common shares  
Unlimited number of preferred shares issuable in series

Issued: Common shares as follows:

	2010		2009	
	Shares	Amount	Shares	Amount
Balance, beginning of year	7,744,546	\$ 17,719	8,098,335	\$ 16,975
Shares issued under stock option plan	78,638	979	94,562	1,455
Shares issued under employee stock purchase plan	31,661	343	24,049	284
Shares repurchased for cash	(147,950)	(352)	(472,400)	(995)
Balance, end of year	7,706,895	\$ 18,689	7,744,546	\$ 17,719

**Share repurchase**

During 2010 (2009), the Company acquired 147,950 (472,400) of its outstanding common shares at an average price of \$ 17.43 (\$10.44) per share for a total of \$2,578 (\$4,933) including related expenses, through normal course issuer bids in place during the periods. The excess of the purchase price over the stated capital of the shares has been charged to retained earnings.

**Employee stock purchase plan**

The Company has an Employee Stock Purchase Plan (ESPP) under which most full-time employees may register once a year to participate in one of two offering periods. Eligible employees may purchase common shares by payroll deduction throughout the year at a price of 80% of the fair market value at the beginning of the initial offering period or may purchase common shares at a price of 90% of the fair market value at the beginning of the interim offering period. Such shares are issued from treasury once a year at the end of the offering periods.

A total of 500,000 common shares have been authorized for issuance under the plan. During 2010 (2009), the Company issued 31,661 (24,049) shares under the ESPP and employees subscribed to approximately 22,740 common shares, which will be issued during fiscal 2011 at an average price of \$14.06. Since inception and including the issuance of shares in 2010, 297,550 shares have been issued under the plan. During 2010, the Company recorded compensation expense of \$61 (2009: \$50) relating to its ESPP.

Contributed surplus:

	2010	2009
Balance, beginning of year	\$ 285	\$ 429
Stock option compensation	20	104
Options exercised	(134)	(248)
	\$ 171	\$ 285

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**

**Years ended September 30, 2010 and 2009**

(Canadian dollars in thousands, except per share data)

## 10. Stock Options

The Company has an established stock option plan, which provides that the Board of Directors may grant stock options to eligible directors and employees. Under the plan eligible directors and employees are granted the right to purchase shares of common stock at a price established by the Board of Directors on the date the options are granted but in no circumstances below fair market value of the shares at the date of grant. A total of 500,000 common shares have been authorized for issuance under the plan, of which 250,000 options have been issued at September 30, 2010.

During 2009 the Company granted 85,000 options to directors and officers at a price of \$9.05 per share with 24,200 vesting immediately and 60,800 options vesting over a period of two years. The options expire on November 18, 2013. No options were granted during 2010. The Company estimates that all options will vest. Any forfeitures are recognized as they occur.

The fair value of options granted during 2009 was \$0.96 per option and was calculated using the Black-Scholes option pricing model using the following weighted average assumptions:

Risk free interest rate	2.3%
Expected dividend yield	7.2%
Stock price volatility	26.7%
Expected life of options	3.47 years

Options outstanding:

	2010		2009	
	Options	Weighted Avg. Exercise Price	Options	Weighted Avg. Exercise Price
Outstanding, beginning of year	155,438	\$ 11.22	165,000	\$ 13.22
Exercised	(78,638)	\$ 10.74	(94,562)	\$ 12.77
Granted	-	\$ -	85,000	\$ 9.05
Outstanding, end of year	76,800	\$ 11.71	155,438	\$ 11.22

	Range of exercise prices		
	\$9.05	\$13.00 - \$13.47	TOTAL
Options outstanding at September 30, 2010	26,800	50,000	76,800
Weighted average exercise price	\$ 9.05	\$ 13.14	\$ 11.71
Weighted average remaining life	3.1 years	1.6 years	2.2 years
Options exercisable at September 30, 2010	8,200	50,000	58,200
Weighted average exercise price	\$ 9.05	\$ 13.14	\$ 12.56

## 11. Earnings Per Share

The diluted weighted average number of shares has been calculated as follows:

	2010	2009
Weighted average number of common shares - basic	7,756,584	7,764,119
Additions to reflect the dilutive effect of employee stock options	34,241	50,865
Weighted average number of common shares - diluted	7,790,825	7,814,984

Options that are anti-dilutive because the exercise price was greater than the average market price of the common shares are not included in the computation of diluted earnings per share. For 2010 and 2009, no options were excluded from the above computation of diluted weighted average number of common shares because they were anti-dilutive.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**12. Interest Income**

Interest income is comprised of the following amounts:

	2010	2009
Interest earned on cash balances	\$ 193	\$ 241
Accreted interest on host contract component of investment	560	474
Interest income	\$ 753	\$ 715

**13. Commitments**

The Company has lease agreements for office space and equipment with terms extending to the year 2019. The aggregate minimum rental payments under these arrangements are as follows:

2011	\$ 2,414
2012	2,273
2013	2,105
2014	2,089
2015	2,090
Thereafter	1,307
Total	\$ 12,278

**14. Contingencies**

In the normal course of business, the Company is party to employee related claims. The potential outcomes related to existing matters faced by the Company are not determinable at this time. The Company intends to defend these actions, and management believes that the resolution of these matters will not have a material adverse effect on the Company's financial condition.

**15. Capital Management**

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business and provide the ability to continue as a going concern. Management defines capital as the Company's shareholders' equity excluding accumulated other comprehensive income relating to cash flow hedges. The Company does not have any debt and therefore net earnings generated from operations are available for reinvestment in the Company or distribution to the Company's shareholders. The Board of Directors does not establish quantitative return on capital criteria for management but rather promotes year over year sustainable profitable growth. The Board of Directors also reviews on a quarterly basis the level of dividends paid to the Company's shareholders and monitors the share repurchase program activities. The Company does not have a defined share repurchase plan and buy and sell decisions are made on a specific transaction basis and depend on market prices and regulatory restrictions. There were no changes in the Company's approach to capital management during the period. Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**

**Years ended September 30, 2010 and 2009**

(Canadian dollars in thousands, except per share data)

**16. Guarantees**

In the normal course of business, the Company enters into agreements that may provide for indemnification and guarantees to customers in transactions such as staffing, outsourcing and engineering. These indemnification undertakings and guarantees may require the Company to compensate customers for costs and losses incurred as a result of various events, including breaches of representations and warranties, intellectual property rights infringement, claims that may arise while providing services, or as a result of litigation that may be suffered by customers. The Company mitigates its potential liability by ensuring its revenue contracts do not contain clauses relating to liability for indirect or special damages such as loss of revenue or profit in all of its engineering agreements. The Company also mitigates the risk of loss by including similar indemnification clauses in the agreements entered into with its subcontractors. The term and nature of these indemnifications vary based upon the agreement, which often provides no limit. Consequently, the Company is unable to make a reasonable estimate of the maximum potential amounts that the Company could be required to pay to its customers. Historically, the Company has not been obligated to make significant payments under these indemnification clauses.

**17. Segmented Information**

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, regarding how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer.

The Company operates in two reportable segments described below, defined by their primary type of service offering, namely Systems Engineering and Business and Technology Services.

- Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector.
- Business and Technology Services involves short and long-term placements of personnel to augment customers' workforces as well as the long-term management of projects, facilities and customer business processes

The Company evaluates performance and allocates resources based on earnings before other expense, interest income and income taxes. The accounting policies of the segments are the same as those described in Note 2.

**For the year ended September 30, 2010**

	<b>Systems Engineering</b>	<b>Business and Technology Services</b>	<b>Corporate</b>	<b>Total</b>
Revenues	\$ 64,000	\$ 151,725	\$ -	\$ 215,725
Operating expenses	52,305	141,290	2,553	196,148
Amortization	492	452	-	944
Earnings before other expense, interest income and income tax expense	\$ 11,203	\$ 9,983	\$ (2,553)	\$ 18,633
Unrealized loss on fair value of conversion options of investment (Note 6)				(52)
Interest income (Note 12)				753
Income tax expense (Note 5)				(5,724)
Net earnings				\$ 13,610
Total assets other than cash and goodwill	\$ 16,507	\$ 33,287	\$ 3,490	\$ 53,284
Goodwill	-	9,518	-	9,518
Cash	-	-	29,055	29,055
Total assets	\$ 16,507	\$ 42,805	\$ 32,545	\$ 91,857
Equipment and intangible expenditures	\$ 668	\$ 710	\$ -	\$ 1,378

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**17. Segmented Information (Continued)**

For the year ended September 30, 2009

	Systems Engineering	Business and Technology Services	Corporate	Total
Revenues	\$ 75,527	\$ 151,703	\$ -	\$ 227,230
Operating expenses	57,742	141,106	2,864	201,712
Depreciation and amortization	651	595	-	1,246
Earnings before other expense, interest income and income tax expense	\$ 17,134	\$ 10,002	\$ (2,864)	\$ 24,272
Unrealized loss on fair value of conversion options of investment (Note 6)				(220)
Loss on share exchange (Note 6)				(125)
Interest income (Note 12)				715
Income tax expense (Note 5)				(8,190)
Net earnings				\$ 16,452
Total assets other than cash and goodwill	\$ 17,436	\$ 30,588	\$ 3,122	\$ 51,146
Goodwill	-	9,518	-	9,518
Cash	-	-	43,662	43,662
Total assets	\$ 17,436	\$ 40,106	\$ 46,784	\$ 104,326
Equipment and intangible expenditures	\$ 755	\$ 637	\$ -	\$ 1,392

Revenues from external customers are attributed as follows:

	2010	2009
Canada	77%	70%
United States	13%	23%
Europe	10%	7%

Revenues are attributed to foreign countries based on the location of the customer. No significant assets are held outside of Canada. Revenues from various departments and agencies of the Canadian federal government for the year ended September 30, 2010 represents 64% (2009: 60%) of the Company's total revenues. Both operating segments conduct business with this major customer.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**  
**Years ended September 30, 2010 and 2009**  
(Canadian dollars in thousands, except per share data)

**18. Financial Instruments and Risk Management**

**Market Risk**

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

*Foreign currency risk related to contracts*

The Company is exposed to foreign currency fluctuations on its cash balance, accounts receivable, accounts payable and future cash flows related to contracts denominated in a foreign currency. Future cash flows will be realized over the life of the contracts. The Company utilizes derivative financial instruments, principally in the form of forward exchange contracts, in the management of its foreign currency exposures. The Company's objective is to manage and control exposures and secure the Company's profitability on existing contracts and therefore, the Company's policy is to hedge 100% of its foreign currency exposure excluding its exposure arising from the Company's US subsidiary. The Company does not utilize derivative financial instruments for trading or speculative purposes. The Company applies hedge accounting when appropriate documentation and effectiveness criteria are met. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm contractually related commitments on projects. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge ineffectiveness has historically been insignificant.

The forward foreign exchange contracts primarily require the Company to purchase or sell certain foreign currencies with or for Canadian dollars at contractual rates. At September 30, 2010, the Company had the following forward foreign exchange contracts:

<b>Type</b>	<b>Notional</b>	<b>Currency</b>	<b>Maturity</b>	<b>Equivalent Cdn. Dollars</b>	<b>Fair Value September 30, 2010</b>
SELL	19,628	USD	October 2010	\$ 20,252	\$ 56
SELL	1,000	USD	September 2015	1,057	28
SELL	1,000	USD	September 2016	1,057	28
SELL	1,000	USD	September 2017	1,057	28
SELL	6,563	EURO	October 2010	9,189	18
<b>Derivative assets</b>					<b>\$ 158</b>
BUY	4,065	USD	October 2010	\$ 4,194	\$ 11
BUY	12,262	EURO	October 2010	17,168	35
BUY	98	GPB	October 2010	160	2
<b>Derivative liabilities</b>					<b>\$ 48</b>



**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**

**As at September 30, 2010 and 2009**

(dollars in thousands, except per share data)

**18. Financial Instruments and Risk Management (Continued)**

At September 30, 2009, the Company had the following forward foreign exchange contracts:

Type	Notional	Currency	Maturity	Equivalent Cdn. Dollars	Fair Value September 30, Fair Value 2009
SELL	25,040	USD	October 2009	\$ 27,114	\$ 303
BUY	16,480	EURO	October 2009	26,197	376
Derivative assets					\$ 679
SELL	4,211	USD	October 2009	\$ 4,560	\$ 51
BUY	14,196	EURO	October 2009	22,566	324
BUY	120	GBP	October 2009	208	2
Derivative liabilities					\$ 377

A 10% strengthening (weakening) of the Canadian dollar against the following currency at September 30, 2010 would have increased (decreased) other comprehensive income as related to the forward foreign exchange contracts by the amounts shown below.

	<b>2010</b>
USD	\$ 1,560
EURO	790
GBP	(15)
	\$ 2,335

*Foreign currency risk on US-based subsidiary*

The Company is exposed to foreign currency fluctuations related to its net investment in a US-based subsidiary denominated in US dollars. The Company does not hedge its investment in the subsidiary as the currency position is considered long term in nature. At September 30, 2010 the net investment in the US-based subsidiary was \$851. A 10% strengthening (weakening) of the Canadian dollar against the US dollar at September 30, 2010 would have decreased (increased) OCI by \$83.

**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 contractual obligations, and arises principally from the Company's accounts receivable and its foreign exchange contracts.

The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristics of each customer. The Company's customers are for the most part, federal and provincial government departments and large private companies. A significant portion of the Company's accounts receivable is from long-time customers. At September 30, 2010 73% of its accounts receivable were due from the Government of Canada. Over the last five years, with the exception of the loss recognized with regards to Nortel, the Company has not suffered any significant credit related losses.

The Company limits its exposure to credit risks from counter-parties to derivative financial instruments by dealing only with major Canadian financial institutions. Management does not expect any counter-parties to fail to meet their obligations.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**

**As at September 30, 2010 and 2009**

(dollars in thousands, except per share data)

**18. Financial Instruments and Risk Management (Continued)**

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	<b>2010</b>	<b>2009</b>
Cash	\$ 29,055	\$ 43,662
Accounts receivable	33,954	32,816
Derivative assets	158	679
Long-term investment	3,417	3,037
	<b>\$ 66,584</b>	<b>\$ 80,194</b>

The aging of accounts receivable at the reporting date was:

	<b>2010</b>	<b>2009</b>
Current	\$ 33,072	\$ 32,428
Past due (61-120 days)	701	209
Past due (> 120 days)	181	179
	<b>\$ 33,954</b>	<b>\$ 32,816</b>

Based on historic default rates, the Company believes that there are minimal requirements for an allowance for doubtful accounts.

**Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet liabilities when due. At September 30, 2010 the Company has a cash balance of \$29,055 and has an unsecured credit facility, subject to annual renewal. The credit facility permits the Company to borrow funds up to an aggregate of \$10,000. As at September 30, 2010 an amount of \$612 was drawn to issue a letter of credit to meet customer contractual requirements. All of the Company's financial liabilities have contractual maturities of less than 30 days.

**Fair Value**

The fair value of accounts receivable, accounts payable and accrued liabilities approximates their carrying values due to their short-term maturity.

Fair value of the forward exchange contracts reflects the cash flows due to or from the Company if settlement had taken place on September 30, 2010.

The fair value of the conversion options of the long-term investment is calculated using the Black-Scholes model that incorporates current market price, the contractual price and the volatility of the underlying instrument, the expected life of the option and the time value of money.

**Calian Technologies Ltd.**  
**Notes to the Consolidated Financial Statements**

**As at September 30, 2010 and 2009**

(dollars in thousands, except per share data)

**18. Financial Instruments and Risk Management (Continued)**

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 of the fair value hierarchy based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	<b>2010</b>	<b>2010</b>
	<b>Level 1</b>	<b>Level 2</b>
Cash	\$ 29,055	\$ -
Derivative financial assets	-	158
Derivative financial liabilities	-	(48)
Total	\$ 29,055	\$ 110

There were no transfers between Level 1 and Level 2 during the period.

**19. Pension Plan**

The Company sponsors a defined contribution pension plan for certain of its employees. Required contributions have been fully funded to September 30, 2010. For the year 2010 (2009), an amount of \$708 (\$778) was expensed related to this pension plan.

## Corporate Information

### Corporate & Business and Technology Services

340 Legget Drive, Suite 101,  
Ottawa, Ontario, Canada K2K 1Y6  
Phone: 613.599.8600  
Fax: 613.599.8650  
Web: www.calian.com

### Systems Engineering (SED)

P.O. Box 1464  
18 Innovation Blvd.  
Saskatoon, Saskatchewan, Canada S7K 3P7  
Phone: 306.931.3425  
Fax: 306.933.1486  
Web: www.sedsystems.ca

### United States Office

7960 Donegan Drive  
Suite 223  
Manassas, Virginia, USA 20109  
Phone: 703.392.4950  
Fax: 703.392.0980

## Board of Directors

### Kenneth J. Loeb

Chief Executive Officer, Loeb Packaging Ltd.  
Chairman, Calian Technologies Ltd.  
Chair of the Nominating Committee

### Larry O'Brien

Director

### Major General (retired) C. William Hewson

Consultant  
Chair of the Governance Committee

### David Tkachuk

Senator  
Chair of the Compensation Committee

### Richard Vickers, FCA

Consultant  
Chair of the Audit Committee

### Paul Cellucci

Special counsel to McCarter and English, LLP

### Ray Basler

President and CEO, Calian Technologies Ltd.

## Common Share Information

The Company's common shares are listed for trading on the Toronto Stock Exchange under the symbol CTY.

## Dividend Policy

The Company intends to continue to declare a quarterly dividend in line with its overall financial performance and cash flow generation. Decisions on dividend payments are made on a quarterly basis by the Board of Directors. There can be no assurance as to the amount of such dividends in the future.

## Annual Meeting of Shareholders

The Annual General Meeting of the Shareholders of Calian will be held on February 11, 2011 at 2:00 p.m. at the Brookstreet Hotel, Ottawa, Ontario, Canada. All shareholders are invited to attend. The telephone number of the Brookstreet Hotel is 613.271.1800.

**2010** Annual Report  
Calian Technologies Ltd.