# 2011

## Annual Report
## Calian Technologies Ltd.

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## Message from the Chairman

2011 was yet another successful year for Calian and I am pleased with the performance of our management team, particularly in these volatile economic times. Our unwavering emphasis on quality has kept our reputation intact, even in the midst of intense competition. By focusing on business fundamentals we were able to achieve high marks in execution and customer satisfaction while at the same time providing a respectable return to our shareholders.

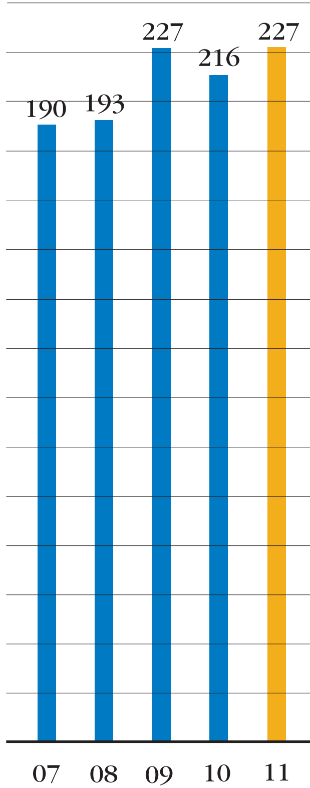
You as shareholders have entrusted us with the stewardship and safeguarding of the assets and business affairs of Calian. Accordingly we continue to place a great deal of emphasis on corporate governance and ethical business practices. A majority of our directors are independent and are all involved in every committee of the board. This affords them a direct view of the company's affairs in order to better provide support and guidance to management; be it in the creation and execution of operational plans and strategies, or the development and ultimately the succession of management, necessary to ensure long-term stability.

I am very proud of the Company's accomplishments over the past year and I share management's excitement for the opportunities of the future. As a board, we believe that Calian has a strong and seasoned management team, a solid balance sheet and an enviable backlog of work; all key ingredients to weathering the current economic uncertainty while providing you, our shareholders, with continued superior results in the future.

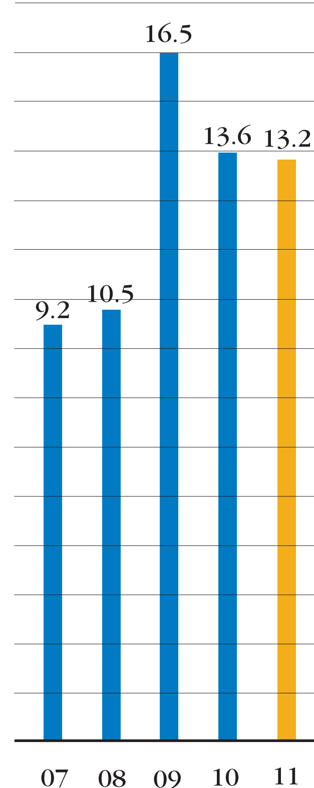
**Kenneth Loeb**
*Chairman*

(millions of dollars, except per share data)

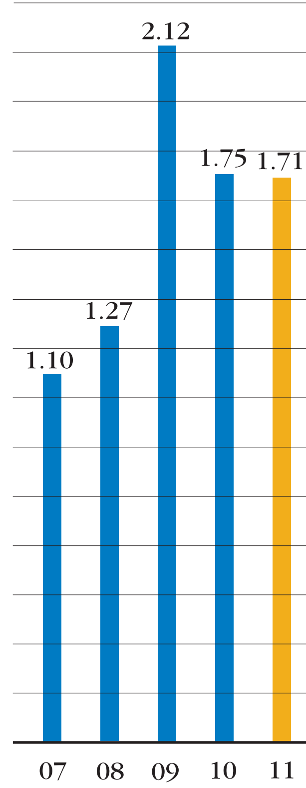
**Revenues**



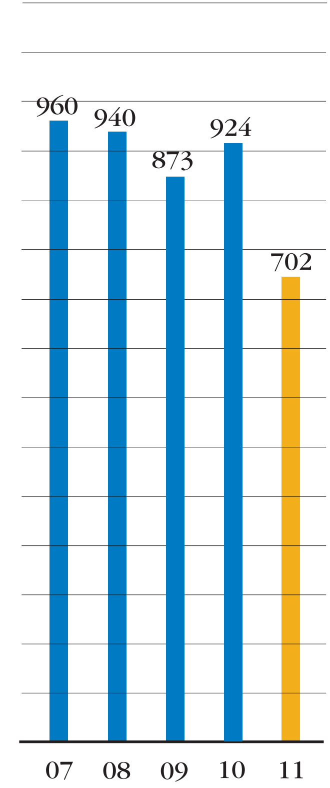

**Net Earnings**



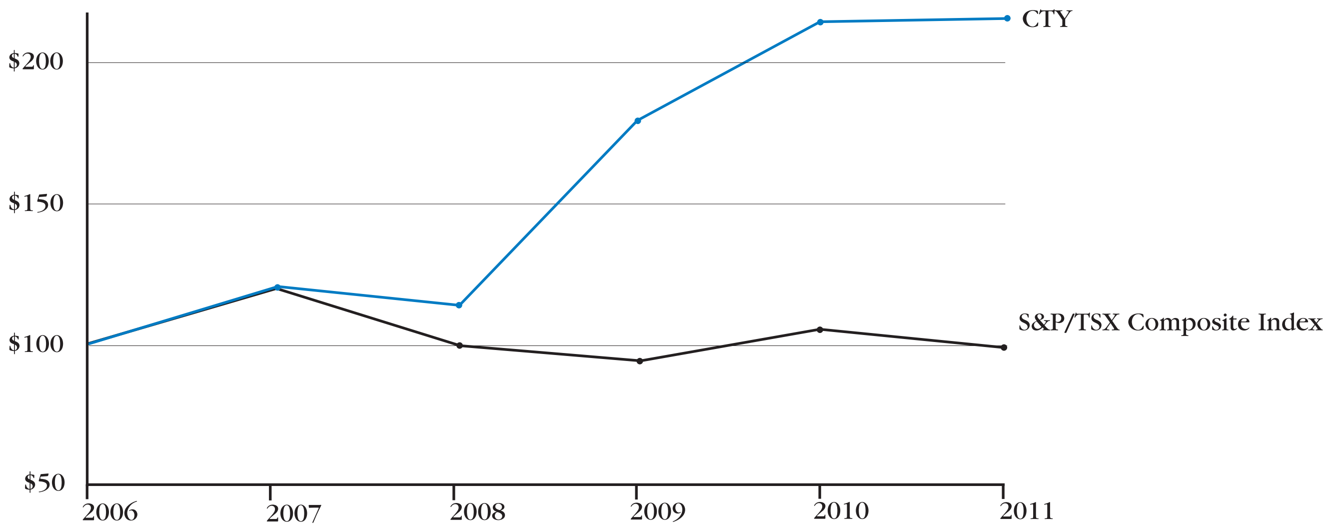

**Earnings Per Share**




**Backlog**




**Comparison of Cumulative Total Return**



## Message from the President and CEO

2011 was a year focused on execution of longer term contracts while retaining market share on new pursuits. As many long-term contracts were signed or renewed in prior years, we had a reasonable base of work entering the year and profitable execution was paramount. At the same time, we were experiencing increased competition on new opportunities that required creative and aggressive approaches to maintaining market share. Fortunately the diversity of our service offerings and our strong backlog allowed us to take a measured and controlled approach to new business by focusing on areas with potential for higher growth and/or margin preservation. The result was modest growth with very respectable earnings levels; attributes that are highly valued by investors during uncertain times.

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.

Our SED division faced a less-than-ideal business environment as we entered 2011. The prolonged unsettled economic landscape served to constrain capital spending at many of our international satellite customers and new satellite ventures were practically non-existent. Likewise, demand for contract manufacturing from our US based military customers was somewhat unpredictable as they too struggled with shifting priorities and budget constraints. Fortunately, our continual focus on quality, customer satisfaction and schedule performance has earned a level of new business from existing customers that allowed the division to achieve revenues consistent with the prior year. While competitive pressures combined with the negative effect of a strong Canadian dollar dampened margins, the division achieved bottom line results that are still impressive for a systems integrator operating in an international marketplace.

Our BTS division was affected by a number of factors during the year. Firstly, we experienced a slowdown in government spending both before and after the most recent federal election. In addition, utilization on longer term military contracts tended to be somewhat more volatile than past years. On the positive side, our short-term staffing group realized significant increases in revenues as activity levels in both the public and private sectors were robust for most of the year. Overall the division reported a revenue increase of 6% compared to the prior year.

During the year the BTS division underwent a transfer of leadership due to the retirement of Tom Coates after 20 years of service with Calian. The transfer of divisional leadership to Kevin Ford was virtually seamless and is testament to the underlying strength and discipline that exists in the organization. A recent organizational realignment in the BTS division will allow us to streamline our service delivery while at the same time, better pursue our target markets. I have every confidence that this change, once fully implemented, will enhance both revenue growth and bottom line contribution from the division in future years.

Overall, we achieved consolidated revenues of $227 million representing an increase of 5% over the prior year. Unfortunately, intense competition coupled with a strong Canadian dollar served to put significant pressure on margins. While close control of operating costs helped to mitigate some of the margin reduction, the resulting overall earnings were $1.71 per share. This represents a slight drop from the prior year, but still very respectable considering the volatility in today's business environment. Our unwavering focus on cash flows has once again yielded a strong cash position and a high return on invested capital.

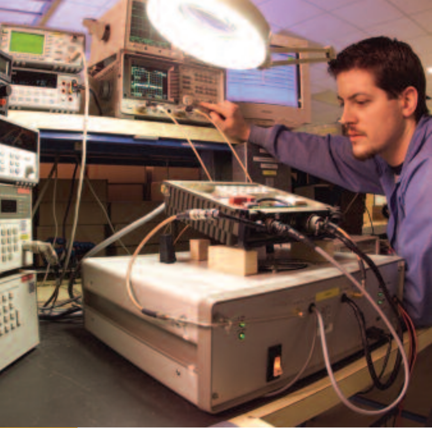
During the year we once again increased our quarterly dividend which now stands at an annual rate of $1.00 per share. Dividends paid during 2011 represented a yield in excess of 5% over the course of the year. In the absence of major cash requirements, we plan to continue our policy of paying dividends at levels commensurate with after tax earnings. Including the reinvestment of dividends, our shareholders realized a modest single digit return for the year; not significant in absolute terms, but still a bettering of the overall return of the TSX by more than 7% during the same period.

We continued to repurchase shares under the Normal Course Issuer Bid, purchasing 81,600 shares during the year at an average price of $18.23 per share. While these amounts were relatively low due to regulatory restrictions and lower overall trading levels, we believe that the repurchase of shares at recent price levels continues to constitute an excellent use of cash resources to enhance shareholder value.

In summary, I am very pleased with the results for the year, particularly during these unsettled economic times. Armed with a solid backlog of work and a strong balance sheet, our seasoned management team is poised to take advantage of future growth opportunities; all with the goal of providing you, our shareholders, with superior returns and a growing and reliable dividend stream for the years ahead.

**Ray Basler**

*President and CEO*



## Report on Operations - Systems Engineering (SED)

Once again, 2011 was a year of both challenges and opportunities for the SED division. As a project-based entity primarily serving international customers, SED must continually contend with not only the ebbs and flows of business cycles, but also extraneous issues such as currency fluctuations and foreign logistics. That being said, our strong reputation for quality and on-time delivery has provided us with a steady flow of repeat business from our key customers. Despite the unsettled business and political environment in 2011, we were able to record revenues of $66 million and divisional contribution of $10.3 million, or 15.6%.

Entering the year, we had expectations that our manufacturing business would be slower than the previous year. While we continued to manufacture Control Electronics Processors (CEP) and harnesses for KDS, albeit at reduced levels, we were fortunate to receive two substantial orders from DRS for Arial Head Assemblies for their MSTAR product. This helped to offset the decline in revenue from KDS and improved utilization within the manufacturing group. In the latter half of the year, we received a significant volume of orders from Research in Motion for test sets, circuit boards and harnesses for the testing of their new Blackberry handheld devices. In addition, near the end of the fiscal year, we received a major order from KDS for CEPs and harnesses. While this contributed marginally to 2011, it provides a solid foundation of work going into next year. Overall, with the increased level of activity throughout the year, revenue from the manufacturing group was almost identical to the prior year.

In the Communication Systems segment, we signed two major contracts for design and supply of satellite earth stations. The first was with Boeing Satellite Systems for the supply and installation of two TT&C earth stations for the Mexsat project. The second was with iDirect for the supply of three gateway earth station for the Inmarsat 5 project. This contract has excellent follow-on potential as there is a high probability of additional antenna systems being required for back-up purposes. Both of these projects will provide ongoing revenue throughout 2012.

Work continued on the third deep space antenna for the European Space Agency. The in-plant development is nearing completion and construction of the antenna structure in Argentina continues. Installation of the RF equipment and final testing of the entire station is expected to be completed in 2012.

Our Network Management group was successful in winning a contract to provide Skywave Mobile Communications with two Access Control and Signaling Systems for their new Inmarsat data service. These systems, installed in Canada and New Zealand, were completed within a year despite a considerable amount of new development. Late in the fiscal year, we were awarded a contract by Inmarsat to develop an enhanced safety service for their Aeronautical system. In addition to these new projects we continued to do upgrades and enhancements for a number of systems that we had previously provided to Inmarsat and Sirius XM.

Our satellite operations contracts continue to generate a steady stream of profitable 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. 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 2007. We are also under a long-term contract to provide 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 under a multi-year contract with LightSquared Company. This gateway facility provides the core capability to allow us to expand our business in satellite operations.

In conclusion, although 2011 had its challenges, SED was able to once again generate respectable revenue levels and provide solid divisional contribution.

On a personal note, I will be retiring at the end of 2011. I am very proud of the progress made by the division over the past number of years and its record of solid and consistent profitability. I have every confidence that Patrick Thera, who has 25 years of experience with SED, will carry on the division's focus on quality, customer satisfaction and controlled profitable growth.

**Brent McConnell**

*VP and General Manager, Systems Engineering*

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

The Business and Technology Services Division navigated through many challenges this year: a very competitive business environment, a federal election, a change in divisional leadership and a strategic organizational realignment. Despite these challenges, the division achieved modest revenue growth, but increased competition and margin pressures resulted in the divisional contribution being flat compared to previous year's results.

Our Outsourcing group achieved the majority of their performance objectives during the year in terms of managing and growing existing contracts. Unfortunately, some new business prospects were delayed and accordingly significant effort was expended on cementing relationships for longer term opportunities. Some larger contracts, like the simulation based training provided by our teams at the Directorate of Land Synthetic Environments, and the vehicle maintenance we perform under the National Maintenance Contract (NMC), both experienced growth fuelled by increased demand from the customer coupled with extremely high customer satisfaction. Our performance on the NMC and the Health Service Support Contract was exemplary and formal assessments from both customers have indicated a high level of performance and satisfaction. In addition two contracts were won to support DND in their installation, configuration and maintenance of telecommunications equipment in Alberta, BC and Manitoba.

Our Staffing group experienced a strong financial year with the Ottawa, Toronto and Montreal locations all showing substantial increases in revenues compared to the prior year. The division is continuing to benefit from our past investment to pursue and win multi-year/multi-person opportunities in both private and public sectors as well as capitalizing on contract vehicles that have provided the opportunity to work with new clients. Our staffing business is well positioned and will look to continue to diversify in 2012 by winning larger opportunities, vendor of records and long term supply arrangements in our target sectors.

Our back office group working closely with the operating business units, successfully achieved 2011 objectives. Realigning 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. We have become a founding partner of Excellence Canada (formerly National Quality Institute) and will continue to leverage best practices from this organization as a cornerstone of our continuous improvement culture.

Looking ahead, the division has been reorganized to strengthen the focus on our core service lines; Health, Operations and Maintenance, IT Professional Services and Training. Our growth strategy will have four thrusts – protecting our current client base through continued delivery excellence, diversifying our client based in new targeted Canadian sectors, evolving our service lines to expand capabilities and increase the value and scope of our service offerings, and finally continued process improvement to innovate and scale our back office capabilities as an enabler to our growth agenda.

We are starting 2012 on a solid foundation for growth - a strong backlog and opportunity funnel, a new organization structure, tactical plans aligned to our updated strategy and a team that has demonstrated time and time again the ability to be our clients trusted program delivery partner. I have thoroughly enjoyed my first year at Calian and I am pleased with this year's divisional accomplishments. We have a great team who are committed and focused to deliver excellent results in the coming year.

**Kevin Ford**

*VP and General Manager,*
*Business & Technology Services*

## Business of the Company

We operate through two 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 focus is on two distinct markets. Our primary market is satellite communications sector where we serve satellite manufacturers, operators and service providers around the world. We also provide satellite operations services to government and commercial clients in the same market sector. Our other market is in the defense/security and high-end telecommunications industry where we provide small to medium volume manufacturing services to major players. In both markets, we are a small niche player serving a handful of multi-national organizations working on large worldwide projects. More than 75% of our annual revenues are derived from exports.

Our customers require sophisticated, custom-built infrastructure to meet their unique requirements. Our straightforward approach is to fulfill these requirements by integrating advanced commercial equipment provided from reliable suppliers and where necessary, custom-built components. Our customers rely on our technical and management skills to deliver what we promised, on schedule and at the agreed price. We have a full-service approach helping our customers from design through to long-term operations and support. Our customers reward our success in meeting their expectations with repeat business. Our core competencies make us stand out from our competitors — strong project management, systems engineering know-how, and software development capabilities. We maintain a set of reusable hardware and software components to increase our competitive edge. These strengths have allowed us to establish long-term relationships with many of the industry's leaders.

We apply these same core competencies 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** assists clients by providing strategic long-term outsourcing services, recruiting and placement services, and per-diem staffing services. The division provides ready access to an exceptional team of professionals in IT Professional Services, Healthcare, Operations and Maintenance and Training domains. The division currently 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 across targeted sectors. 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 program delivery capability, 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. 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*

**Kevin Ford**

*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 2, 2011 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 it 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 2, 2011 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, low-volume high-quality contract manufacturing or the provision of specialized personnel in the areas of IT, training, health care and operations and maintenance 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 expand its current service offerings with 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.

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 in a variety of industries 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.

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, 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 that refer 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 46 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 of 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, the wide acceptance of Digital Audio Radio and the move to higher frequency bands 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 mobile broadcast, military use of commercial satellites and the ongoing need to replace the existing capacity of satellites approaching end-of-life. Data intensive applications are also driving the need for high throughput satellite constellations.

Overall, the business environment for the SED division is stable and sustainable. Inmarsat and other operators are increasing capital spending after having operated under restricted capital expenditure philosophies. This should bode well for integrators such as SED. 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 remains 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.

In 2011 the SED division performed well signing $63 million in new contracts and ending the year with a backlog of $71 million of which $41 million is expected to be earned during 2012.

Satellite Operations continue to provide a steady revenue stream. SED continues to operate both of the Radarsat Satellites under contract to 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 LightSquared 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 contract, valued at $39 million, was to be earned over three years. As activities ramped up quickly, it was a major contributor to SED's revenue base in both 2010 and 2011. In addition, during 2011, iDirect was selected as the prime contractor for the ground system for Inmarsat's new Ka Band Global Express VSAT service that will enable Inmarsat to deliver a unique global high-speed mobile broadband service offering. SED subsequently signed a contract with iDirect for provision and installation of antennas and RF Systems for Inmarsat's new program. The baseline contract, valued at nearly $15 million will be executed over a 42 month period. In early 2011, a contract was signed with Boeing Satellite Systems valued at over $6 million for the provision and installation of two gateways, each consisting of two antennas and related RF systems. The systems are to be installed in Mexico and completed in 2013 as part of Boeing's MEXSAT program which will provide end-to-end satellite communications for the Mexican government. 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 has remained steady throughout 2011 and is still a strong contributor to revenues and profitability. Overall, more than $24 million of new manufacturing 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 assembly of test sets for RIM used in the manufacture of their popular Blackberry smartphones has been a consistent contributor to revenues due to the number of new phone models introduced. Also, we continue to manufacture certain component parts for the test sets as well as for RIM's internal consumption.

The markets in which SED operates are currently strong and we expect new opportunities to surface during the year ahead. In addition our manufacturing base is expected to remain steady with levels consistent with those experienced in 2011. 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, particularly as it relates to their new Ka Band Global Express Service. In the Digital Audio Broadcast market, we anticipate additional business with Sirius/XM Radio as they seek to gain commonality in their systems post-merger 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 remain under pressure. Continued volatility of the Canadian dollar relative to other major currencies will 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 in the areas of IT professional services, training, health care and operations and maintenance services.

Across Canada and in parts of the USA, we have a workforce in excess of 2,100 individuals in both full and part-time capacities. Currently 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 or through the long-term management of projects, facilities and customer business processes.

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 (now known as Excellence Canada). In 2009, BTS received a gold level Canada Award of Excellence for Health and Wellness.

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 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.

The overriding influences in all of our areas of business are expected to be determined by four factors: the rate of improvement in the economic recovery in our markets; the transition from public sector stimulus spending to one of public sector deficit reduction and expenditure control; the continuing competitive landscape; and finally the pace of technology evolution and potential impact to our business.

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 steady 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.

All in all, despite the current competitive landscape, we continue to believe that the long-term business environment for the services of the BTS division remains favourable.

2011 has been a year of solid performance. The Health Service Support Contract (HSSC) with DND remains stable and during the year, the Company secured 2 option years. Similarly, the DLSE (Directorate of Synthetic Land Environments) contract generated organic growth as DND continues to require increased demand for training under a contract renewal obtained in the second half of 2009. This contract is expected to continue running strong into 2012 as the team continues to support various DND training initiatives. Although most large contract renewals were secured in prior years, in 2011 BTS was able to grow through modest wins with a variety of customers such as Ericsson, Ciena, Innovapost, Tata Consulting and the public sector.

BTS enters 2012 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. A significant portion of BTS's contracts are not subject to renewal until 2013. This will continue to provide for a stable and secure base of business for fiscal 2012 and allow delivery personnel to focus on increased contract performance, organic contract growth and support of new business development initiatives.

With the Health Services Support Contract (HSSC), we are considered a major player in private sector heath 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 provided the opportunity 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 for 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 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, 2011 was $702 million with terms extending to fiscal 2018. This compares to $924 million reported at September 30, 2010. 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.

During 2011 the following contracts were the major contributors to the Company's backlog. There were no contracts which were cancelled unexpectedly which resulted in a decrease in our backlog; however, due to anticipated underutilization of the Health Services Contract, the related backlog was reduced by $122 million during the year. These contracts are further described in the business overview section of this Management Discussion and Analysis.

- $15 million for a contract with iDirect extending to 2015;
- $23 million in ongoing manufacturing orders from KDS, RIM, Ericsson and DRS;
- $6 million for a contract with Boeing for MexSat earth stations extending to 2013.

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 2012, 2013 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 $125 million. This amount relates to certain government contracts, such as the health services support contract, where the contract maximums exceed expected utilization rates. During 2011, the Company reduced its backlog by $122 million based on DND exercising year eight and nine of the health services support contract with funding levels consistent with those recently experienced. While the excess funding is still available to DND, this was considered an indication that this portion of the contracted backlog would not materialize. 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.

## Backlog

| (dollars in millions) | Fiscal 2012 | Fiscal 2013 | Beyond 2013 | Estimated realizable portion of Backlog | Excess over estimated realizable portion | TOTAL |
|---|---|---|---|---|---|---|
| Contracted Backlog | $ 169 | $ 111 | $ 68 | $ 348 | $ 58 | $ 406 |
| Option Renewals | 14 | 28 | 187 | 229 | 67 | 296 |
| TOTAL | $ 183 | $ 139 | $ 255 | $ 577 | $ 125 | $ 702 |
| Business and Technology Services | $ 142 | $ 127 | $ 237 | $ 506 | $ 125 | $ 631 |
| Systems Engineering | 41 | 12 | 18 | 71 | - | 71 |
| TOTAL | $ 183 | $ 139 | $ 225 | $ 577 | $ 125 | $ 702 |

## Selected Annual Information

(dollars in millions, except per share data)

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Revenues | $ 226.7 | $ 215.7 | $ 227.2 |
| Net earnings | $ 13.2 | $ 13.6 | $ 16.5 |
| Net earnings per share, basic | $ 1.71 | $ 1.75 | $ 2.12 |
| Net earnings per share, diluted | $ 1.71 | $ 1.75 | $ 2.11 |
| Total assets | $ 90.6 | $ 91.9 | $ 104.3 |
| Dividends per share | $ 0.97 | $ 1.79 | $ 0.64 |

## 2011 Results of Operations

Earnings before other income and expense, interest and income taxes were $17,446 in 2011 compared with $18,633 in 2010 and net earnings were $13,181 for the year compared with $13,610 in the previous year. The Company completed the year with $30,742 of cash compared to $29,055 at the end of 2010.

### Revenues

| | 2011 | 2010 | % change |
|---|---|---|---|
| SED revenues | $ 65,716 | $ 64,000 | 3% |
| BTS revenues | $ 160,935 | $ 151,725 | 6% |
| Consolidated revenues | $ 226,651 | $ 215,725 | 5% |

The general business environment in 2011 continued to be very competitive. The Company began the year with $181 million of its backlog to be earned in 2011. This base of work combined with the win of several larger contracts during 2011 resulted in a solid revenue stream for the year.

SED saw continued stability in the satellite industry and although the project mix has changed, the overall level of activity is consistent with the previous year. 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.

In addition to incremental revenues derived from new contracts, BTS experienced steady activity this year on most of its contracts realizing gains in both its outsourcing and staffing groups.

The Company derives a significant portion of its revenues from the Government of Canada. During 2011 (2010), 61% (64%) of revenues were related to contracts with various departments and agencies of the Government of Canada with approximately 53% (55%) directly with DND. Both of the Company's divisions conduct business with the Government of Canada.

Management expects that the marketplace over the next year will continue to be very competitive. The market conditions for SED are expected to continue to be positive and present new opportunities, although the related timing is always subject to change. Current BTS backlog will provide a solid level of activity on existing contracts and new opportunities are expected to arise, although potential government cutbacks could have an impact. The timing of future contract awards and customer demand will ultimately determine revenues for the next year.

## Cost of revenues and Gross profit

| | 2011 | 2010 | % change |
|---|---|---|---|
| SED gross profit | $ 16,414 | $ 17,075 | (4%) |
| As a percentage of SED revenues | 25.0% | 26.7% | |
| BTS gross profit | $ 26,428 | $ 25,707 | 3% |
| As a percentage of BTS revenues | 16.4% | 16.9% | |
| Consolidated gross profit | $ 42,842 | $ 42,782 | 1% |
| As a percentage of consolidated revenues | 18.9% | 19.8% | |

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 warranty costs where applicable.

The consolidated gross margin for 2011 is in line with expectations; reflecting continued downward pressure on margin and is also biased by the smaller proportion of SED revenues.

At SED, with the level of business continuing at more traditional levels, the gross margin for fiscal 2011 was generally in line with expectations and reflects a very competitive landscape in all of SED markets.

The BTS gross margin for the year is slightly below the prior year, and reflects an ever changing project mix.

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 continues to put downward pressure on margins in both divisions. The volatility of the Canadian dollar could impact margins on new work in the SED division.

## Selling and marketing

| | 2011 | 2010 | % change |
|---|---|---|---|
| Selling and marketing | $ 5,304 | $ 4,770 | 11% |
| As a percentage of consolidated revenues | 2.3% | 2.2% | |

Selling and marketing expenses as a percentage of sales remain stable. Costs for 2012 are expected to remain relatively stable over the 2011 level.

## General and administration

| | 2011 | 2010 | % change |
|---|---|---|---|
| General and administration | $ 15,550 | $ 15,310 | 1.6% |
| As a percentage of consolidated revenues | 6.9% | 7.1% | |

General and administration costs in absolute dollars increased slightly in line with cost escalation factors resulting in a decrease as a percentage of revenue. Looking ahead, management believes that general and administration costs will remain mostly in line with activity levels. However, during 2012, BTS expects to increase its business excellence efforts and continue to realign 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

| | 2011 | 2010 | % change |
|---|---|---|---|
| Facilities | $ 3,345 | $ 3,105 | 8% |

Facility expenses, which include costs associated with office space, have been relatively stable over the past several years. 2011 costs were slightly higher than 2010 with certain renewed leases experiencing some rate increases. Overall facility costs are not expected to increase significantly in 2012.

## Depreciation and amortization

| | 2011 | 2010 | % change |
|---|---|---|---|
| Depreciation and amortization | $ 1,128 | $ 944 | 19% |

Depreciation is commensurate with the value and age of the underlying assets. Depreciation for 2012 is expected to remain stable over current levels. 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 increased to $301 in 2011 from $193 in 2010 as a result of an increase in interest rates during 2011.

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

The Company recorded a loss of $52 in 2010 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. With the debenture coming due in fiscal 2011, the fair value of options was insignificant during the year resulting in no gain or loss in 2011.

## Income tax expense

The Company reports its results on a fully taxed basis. The provision for income taxes for 2011 was $5,082 or 27.8% of earnings before income taxes compared to $5,724 or 29.6% of earnings before income taxes in 2010. The decrease in the effective tax rate for 2011 is mainly the result of a decrease in federal and provincial prescribed income tax rates. With prescribed federal and provincial tax rates continuing to decrease, the effective tax rate for 2012, prior to considering the impact of non-taxable transactions, is expected to be approximately 27%.

## Net earnings

The Company reported net earnings of $13,181 or $1.71 per share basic and diluted for 2011 compared to $13,610 or $1.75 per share basic and diluted in 2010.

## Selected Quarterly Financial Data

(dollars in millions, except per share data)

| | Q4/11 | Q3/11 | Q2/11 | Q1/11 | Q4/10 | Q3/10 | Q2/10 | Q1/10 |
|---|---|---|---|---|---|---|---|---|
| Revenues | $ 55.4 | $ 58.5 | $ 59.4 | $ 53.3 | $ 52.9 | $ 57.6 | $ 53.1 | $ 52.1 |
| Net earnings | $ 3.3 | $ 3.5 | $ 3.3 | $ 3.1 | $ 3.2 | $ 3.9 | $ 3.1 | $ 3.4 |
| Net earnings per share | | | | | | | | |
| Basic | $ 0.43 | $ 0.45 | $ 0.42 | $ 0.41 | $ 0.42 | $ 0.49 | $ 0.40 | $ 0.44 |
| Diluted | $ 0.43 | $ 0.45 | $ 0.42 | $ 0.41 | $ 0.42 | $ 0.49 | $ 0.40 | $ 0.44 |

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 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.

## Liquidity and Capital Resources

Calian's net cash position was $30,742 at September 30, 2011, compared to $29,055 at September 30, 2010.

| | 2011 | 2010 |
|---|---|---|
| Cash flows from operating activities before changes in working capital | $ 14,491 | $ 14,656 |
| Changes in working capital | (7,800) | (12,508) |
| Cash flows from operating activities | 6,691 | 2,148 |
| Cash flows used for financing activities | (8,440) | (15,330) |
| Cash flows from (used in) investing activities | 3,414 | (1,378) |
| Currency translation | 22 | (47) |
| Increase (decrease) in cash | $ 1,687 | $ (14,607) |

## Operating activities

Cash inflows from operating activities for the year ending September 30, 2011 were $6,691 compared to $2,148 in 2010. This year's increase is the result of working capital fluctuations in line with the ebbs and flows of the business. The market for the Systems Engineering Division is characterized by 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, 2011, the Company's total unearned contract revenue amounted to $8,026. This compares to $16,002 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 2011. The Company paid quarterly dividends totaling $7,472 or $0.97 cents per share compared to 2010 when the Company paid $6,138 in dividends or $0.79 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 2011, the Company repurchased 81,600 common shares at an average price of $18.23 and during 2010 the Company repurchased 147,950 common shares at an average price of $17.43 through its normal course issuer bids.

At September 30, 2011 there were 150,000 options outstanding at an average price of $16.49 expiring at various dates between February 4, 2012 and November 18, 2013.

At September 30, 2011 there were 7,669,983 common shares outstanding and as of the date of this Management Discussion and Analysis, there were 7,628,483 common shares outstanding.

## Investing activities

### Equipment expenditures

Calian acquired $483 in equipment, furniture and fixtures during 2011, compared to $1,378 during 2010. During 2012 expenditures are expected to be in line with normal levels which approximate $1,000 per year. At September 30, 2011 there were no significant commitments to expend capital assets.

## Investments

During the year, the Company received $3,897 as full payment of a debenture held in AIM Health Group.

### Capital resources

At September 30, 2011 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 | $ 12,402 | $ 2,433 | $ 4,406 | $ 4,354 | 1,209 |
| Purchase obligations | 12,498 | 11,411 | 1,087 | - | - |
| Total contractual obligations | $ 24,900 | $ 13,844 | $ 5,493 | $ 4,354 | 1,209 |

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, 2011.

## Operating leases

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

## Related party transactions

There were no transactions with related parties during 2011 and 2010.

## 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, 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.

### 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 probability of being realized 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, 2011 and 2010 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 purpose of determining fair value, management considered a growth level range of 0% to 5% and a WACC range of 14% to 16%.

## Adoption of New Accounting Policies During The Year

Effective October 1, 2010, the Company changed its accounting policy with regards to the recognition of warranty costs related to fixed price contracts. Previously a provision for warranty claims was established when revenue was recognized, based on the warranty terms and prior claim experience. To better align revenue recognized with the warranty obligations, warranty costs are now included in estimated total contract costs at the beginning of the project and flow through cost of revenues when a warranty claim is made. Revenue is recognized using the percentage completion method based on management's best estimate of the costs to complete each contract. This change in accounting policy is applied retroactively to October 1, 2009 with a reduction in the warranty provision of $3,715 (through accounts payable and accrued liabilities), an increase in unearned contract revenue of $4,239, a decrease in taxes payable of $157 (through accounts payable and accrued liabilities) and a reduction in opening retained earnings of $367. The impact on the net income for the year ended September 30, 2010 and 2011 is not material.

## Impact of Accounting Pronouncements Not Yet Implemented

There were no new accounting pronouncements issued in 2011 which would affect the Company's results of operations or financial conditions.

## 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, 2011. 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; and
- 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.

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. With the exception of modifying the terms of certain hedging contracts related to a long-term customer contract, no significant changes were required;
- A detailed assessment was performed of required changes to systems, processes and documentation. With the exception of adjusting the Company's hedging documentation to reflect IFRS requirements, 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 were performed:

- Monitored standards to be issued by the IASB and provided the related training on such. Assessed 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;
- Completed the data collection to assess the impact of adopting IFRS. Data collection for each quarter in fiscal 2011 was performed shortly following the closing of each quarter under Canadian GAAP;
- Completed the necessary work required to quantify the impact of the changeover to IFRS on the Company's financial position and result of operations at date of transition and affecting the comparative year 2011 and the first reporting year 2012;
- Prepared 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 does 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.

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. **Opening statement of financial position:** An elimination of $357 debit balance in the CTA with an off setting decrease in retained earnings. No impact on total equity. |
| Equipment | Management did not to elect to report equipment, in its opening balance sheet on the transition date, using fair value as the deemed cost instead of the actual cost that would be otherwise determined under IFRS. **Opening statement of financial position:** 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. **Opening statement of financial position:** 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. **Opening statement of financial position:** No impact.. |

The following are areas which contain key differences for the Company between IFRS and Canadian generally accepted accounting principles. A change in the Company's accounting policies required under IFRS in these areas could have a significant impact with respect to the recognition and measurement of certain statement of financial position and income statement items. Unless otherwise indicated, all changes in accounting policies 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. | **Opening statement of financial position:** 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. **Opening statement of financial position and subsequent to transition:** 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 exists 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. | **Opening statement of financial position:** 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. **Subsequent to transition:** A review will be performed at each balance sheet date to determine if any new provisions should be recognized. |
| 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. | **Opening statement of financial position:** No impact is expected. **Subsequent to transition:** The impact on earnings, if any, 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 hedging 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). | **Opening statement of financial position:** No impact is expected. **Subsequent to transition:** The impact on earnings, if any is not expected to be significant. |

| Accounting policy | Key differences in accounting treatment | Potential key impacts |
|---|---|---|
| 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. | **Opening statement of financial position:** A liability of $1,315 was set-up related to the outstanding repurchase of shares through the normal course issuer bid (NCIB) with adjustments of $178 and $1,137 to share capital and retained earnings account respectively. **Subsequent to transition:** The liability will be adjusted for any subsequent changes to the NCIB agreement. An income adjustment will result on any share repurchased below the maximum amount per share. Based on historical trends, the amount of income to be recognized is expected to be minimal. |
| Presentation and disclosure | IFRS minimum presentation and disclosure is different than Canadian GAAP. | **Opening statement of financial position and subsequent to transition:** The format of the balance sheet and profit and loss statement was changed to reflect the required presentation and disclosure. |
| Statement of cash flows | IFRS allows the option of presenting the statement of cash flow using either the direct method or indirect method. | Management has elected to present its Statement of cash flow using the indirect method. **Opening statement of financial position and subsequent to transition:** No impact. |

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, 2011, 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, 2011, 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, 2011, 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, perfomance, 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 (now known as Excellence Canada). 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.

### 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 2011, approximately 61% 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, 2011 the Company's backlog included $125 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.

### 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 22% 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, 2011 the Company had various forward exchange contracts, which are explained in Note 19 to the Company's consolidated financial statements for the year ended September 30, 2011. 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.

## Long-term Outlook

Management believes the Company is well positioned for 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 to 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. Custom manufacturing activity levels will continue to be directly dependent 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 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 and the division continues to assess how it can service new markets and increase new opportunities available to the division.

## Additional Information

Additional information about the Company such as the Company's 2011 Annual Information Form and Management Circular can be found on SEDAR at www.SEDAR.com

Dated: December 2, 2011

## 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 8, 2011*

**Jacqueline Gauthier**

*Chief Financial Officer*

# Independent Auditor’s Report

To the Shareholders of Calian Technologies Ltd.

We have audited the accompanying consolidated financial statements of Calian Technologies Ltd., which comprise the consolidated balance sheets as at September 30, 2011 and 2010, and the consolidated statements of earnings and retained earnings, comprehensive income, accumulated other comprehensive income (loss) and retained earnings and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Calian Technologies Ltd. as at September 30, 2011 and 2010 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 8, 2011*
*Ottawa, Ontario*

# Calian Technologies Ltd.
# Consolidated Statements of Earnings and Retained Earnings
## Years ended September 30, 2011 and 2010
(Canadian dollars in thousands, except per share data)

| | 2011 | 2010 (Note 3) |
|---|---|---|
| Revenues | $ 226,651 | $ 215,725 |
| Cost of revenues | 183,809 | 172,943 |
| Gross profit | 42,842 | 42,782 |
| Selling and marketing | 5,304 | 4,770 |
| General and administration | 15,550 | 15,310 |
| Facilities | 3,345 | 3,105 |
| Stock option compensation (Note 11) | 69 | 20 |
| Depreciation and amortization | 1,128 | 944 |
| Earnings before other expense, interest income and income tax expense | 17,446 | 18,633 |
| Unrealized loss on fair value of conversion options of investment (Note 7) | - | (52) |
| Interest income (Note 13) | 817 | 753 |
| Earnings before income tax expense | 18,263 | 19,334 |
| Income tax expense (Note 6): | | |
| Current | 4,557 | 5,195 |
| Future | 525 | 529 |
| | 5,082 | 5,724 |
| **NET EARNINGS** | $ 13,181 | $ 13,610 |
| Retained earnings, beginning of year | 39,769 | 42,692 |
| Adjustment to opening retained earnings for a change in accounting policy (Note 3) | - | (367) |
| Excess of purchase price over stated capital on repurchase of shares (Note 10) | (1,287) | (2,226) |
| Dividends | (7,472) | (13,940) |
| Retained earnings, end of year | $ 44,191 | $ 39,769 |
| Net earnings per share (Note 12) | | |
| Basic | $ 1.71 | $ 1.75 |
| Diluted | $ 1.71 | $ 1.75 |
| Weighted average number of shares (Note 12) | | |
| Basic | 7,697,217 | 7,756,584 |
| Diluted | 7,715,165 | 7,790,825 |

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

# Calian Technologies Ltd.
# Consolidated Balance Sheets
## As at September 30, 2011 and 2010
(Canadian dollars in thousands)

| | 2011 | 2010 (Note 3) |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash | $ 30,742 | $ 29,055 |
| Accounts receivable | 35,181 | 33,954 |
| Work in process | 6,960 | 3,576 |
| Prepaid expenses (Note 5) | 2,751 | 6,329 |
| Future income taxes (Note 6) | 480 | 696 |
| Derivative assets (Note 19) | 451 | 158 |
| Investment (Note 7) | - | 953 |
| | 76,565 | 74,721 |
| INVESTMENT (Note 7) | - | 2,464 |
| EQUIPMENT (Note 8) | 4,069 | 4,611 |
| INTANGIBLES (Note 9) | 440 | 543 |
| GOODWILL | 9,518 | 9,518 |
| | $ 90,592 | $ 91,857 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued liabilities | $ 18,594 | $ 17,024 |
| Unearned contract revenue | 8,026 | 16,002 |
| Derivative liabilities (Note 19) | 1,054 | 48 |
| | 27,674 | 33,074 |
| COMMITMENTS (Note 14) AND CONTINGENCIES (Note 15) | | |
| SHAREHOLDERS' EQUITY | | |
| Share capital (Note 10) | 19,091 | 18,689 |
| Contributed surplus (Note 10) | 219 | 171 |
| Retained earnings | 44,191 | 39,769 |
| Accumulated other comprehensive income (loss) | (583) | 154 |
| | 62,918 | 58,783 |
| | $ 90,592 | $ 91,857 |

*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 (Loss)
### Years ended September 30, 2011 and 2010
(Canadian dollars in thousands)

| | 2011 | 2010 (Note 3) |
|---|---|---|
| Net earnings | $ 13,181 | $ 13,610 |
| Unrealized gain (loss) on translating financial statements of self-sustaining foreign operation, net of tax of nil | 22 | (47) |
| Change in deferred gain (loss) on derivatives designated as cash flow hedges, net of tax of $312 (2010: $246) | (759) | 512 |
| Other comprehensive income (loss) | (737) | 465 |
| Comprehensive income | $ 12,444 | $ 14,075 |

# Calian Technologies Ltd.
# Consolidated Statements of Accumulated Other Comprehensive Income (Loss) and Retained Earnings
### Years ended September 30, 2011 and 2010
(Canadian dollars in thousands)

| | 2011 | 2010 (Note 3) |
|---|---|---|
| Unrealized cumulative loss on translating financial statements of self-sustaining foreign operation, net of tax | $ (335) | $ (357) |
| Deferred gain (loss) on derivatives designated as cash flow hedges, net of tax | (248) | 511 |
| Accumulated other comprehensive income (loss), end of year | (583) | 154 |
| Retained earnings, end of year | 44,191 | 39,769 |
| Accumulated other comprehensive income (loss) and retained earnings, end of year | $ 43,608 | $ 39,923 |

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

# Calian Technologies Ltd.
# Consolidated Statements of Cash Flows
## Years ended September 30, 2011 and 2010
(Canadian dollars in thousands)

| | 2011 | 2010 (Note 3) |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net earnings | $ 13,181 | $ 13,610 |
| Items not affecting cash | | |
| Interest accreted on host contract component of long-term investment (Note 13) | (480) | (560) |
| Employee stock purchase plan compensation expense (Note 10) | 68 | 61 |
| Stock option compensation (Note 11) | 69 | 20 |
| Depreciation and amortization | 1,128 | 944 |
| Future income tax expense (Note 6) | 525 | 529 |
| Unrealized loss on fair value of conversion options of long-term investment (Note 7) | - | 52 |
| | 14,491 | 14,656 |
| Change in non-cash working capital | | |
| Accounts receivable | (1,294) | (996) |
| Work in process | (3,384) | (810) |
| Prepaid expenses (Note 5) | 3,578 | (673) |
| Accounts payable and accrued liabilities | 1,276 | (1,000) |
| Unearned contract revenue | (7,976) | (9,029) |
| | 6,691 | 2,148 |
| CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES | | |
| Issuance of common shares (Note 10) | 519 | 1,188 |
| Dividends | (7,472) | (13,940) |
| Repurchase of shares (Note 10) | (1,487) | (2,578) |
| | (8,440) | (15,330) |
| CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES | | |
| Equipment and intangible expenditures | (483) | (1,378) |
| Investment | 3,897 | - |
| | 3,414 | (1,378) |
| FOREIGN CURRENCY ADJUSTMENT | 22 | (47) |
| NET CASH INFLOW (OUTFLOW) | 1,687 | (14,607) |
| CASH, BEGINNING OF YEAR | 29,055 | 43,662 |
| CASH, END OF YEAR | $ 30,742 | $ 29,055 |
| SUPPLEMENTARY INFORMATION: | | |
| Income taxes paid | $ 4,719 | $ 5,973 |

*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, 2011 and 2010
(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.

### 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's best estimates of costs to complete each contract, including warranty costs. Billings in advance of amounts earned are reflected as unearned contract revenue. Revenues earned but not yet billed are reflected as unbilled receivables. 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. 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, 2011 and 2010.

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.

## 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 in contributed surplus.

Consideration paid by employees on the purchase of shares or exercise of options are recorded as share capital when the shares are issued; the amount recorded to contributed surplus in respect to stock-based compensation is reclassified to share capital.

### 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.

### Investment

The Company's investment at September 30, 2010 was considered a hybrid instrument as it included rights of conversion to common shares. The conversion options were considered to be embedded derivatives to be separated and valued independently of the underlying debenture investment "host contract". The conversion options were 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 was 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.

### Work in process

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

### 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.

## 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, 2011 and 2010, 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.

## 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 |
| Investment – conversion option | Held for trading |
| Investment – host contractt | 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. The Company currently does not have any assets designated as available-for-sale.

#### 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.

## 3. Change in Accounting Policies

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.

Effective October 1, 2010, the Company changed its accounting policy with regards to the recognition of warranty costs related to fixed price contracts. Previously a provision for warranty claims was established when revenue was recognized, based on the warranty terms and prior claim experience. To better align revenue recognized with the warranty obligations, warranty costs are now included in estimated total contract costs at the beginning of the project and flow through cost of revenues when a warranty claim is made. Revenue is recognized using the percentage completion method based on management's best estimate of the costs to complete each contract. This change in accounting policy is applied retroactively to October 1, 2009 with a reduction in the warranty provision of $3,715 (through accounts payable and accrued liabilities), an increase in unearned contract revenue of $4,239, a decrease in taxes payable of $157 (through accounts payable and accrued liabilities) and a reduction in opening retained earnings of $367. The impact on the net income for the year ended September 30, 2010 and 2011 is not material.

## 4. New Accounting Pronouncements

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 the Company's financial statements beginning on or after October 1, 2011.

## 5. Prepaid Expenses

| | 2011 | 2010 |
|---|---|---|
| Prepaid operating expenses | $ 1,233 | $ 705 |
| Milestone advance to subcontractor | 1,518 | 5,624 |
| | $ 2,751 | $ 6,329 |

## 6. 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:

| | 2011 | 2010 |
|---|---|---|
| Earnings before income taxes | $ 18,263 | $ 19,334 |
| Tax provision at the combined basic Canadian federal and provincial income tax rate of 28.8% (2010: 31.4%) | 5,260 | 6,067 |
| Increase (decrease) resulting from: | | |
| Permanent differences | 12 | (101) |
| Impact of rate reductions on valuation of future income tax assets | 42 | 74 |
| Other | (232) | (316) |
| Income tax expense | $ 5,082 | $ 5,724 |

The balances of future income tax assets at September 30, 2011 and 2010 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.

## 7. Investment

On July 11, 2006, the Company invested $3,623 in Med-Emerg International Inc. (Med-Emerg) in the form of convertible preferred shares and on January 20, 2009, Med-Emerg announced a merger with AIM Health Group Inc. (AIM). 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. On January 6, 2011, AIM repaid $1,000 of the debenture in cash. Subsequently, on June 30, 2011, the remaining convertible debenture was settled through the issuance of a new convertible debenture and in July and August, 2011, AIM repaid the remaining amount of the debenture. The carrying value of the investment was as follows:

| | 2011 | 2010 |
|---|---|---|
| AIM investment, at cost on January 20, 2009 | $ 2,517 | $ 2,517 |
| AIM cumulative unrealized loss on conversion options | (17) | (17) |
| AIM cumulative interest accretion on host contract | 1,397 | 917 |
| Payments during 2011 | (3,897) | - |
| Carrying value of investment at September 30 | $ - | $ 3,417 |
| Short-term portion | - | 953 |
| Long-term portion | $ - | $ 2,464 |

## 8. Equipment

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Leasehold improvements | $ 1,462 | $ 483 | $ 979 | $ 1,478 | $ 340 | $ 1,138 |
| Equipment and furniture | 9,856 | 6,766 | 3,090 | 9,546 | 6,073 | 3,473 |
| | $ 11,318 | $ 7,249 | $ 4,069 | $ 11,024 | $ 6,413 | $ 4,611 |

## 9. Intangibles

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Application software | $ 2,250 | $ 1,810 | $ 440 | $ 2,195 | $ 1,652 | $ 543 |

## 10. Share Capital and Contributed Surplus

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

Issued: Common shares as follows:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Shares | Amount | Shares | Amount |
| Balance, beginning of year | 7,706,895 | $ 18,689 | 7,744,546 | $ 17,719 |
| Shares issued under stock option plan | 21,800 | 218 | 78,638 | 979 |
| Shares issued under employee stock purchase plan | 22,888 | 385 | 31,661 | 343 |
| Shares repurchased for cash | (81,600) | (201) | (147,950) | (352) |
| Balance, end of year | 7,669,983 | $ 19,091 | 7,706,895 | $ 18,689 |

Share repurchase

During 2011 (2010), the Company acquired 81,600 (147,950) of its outstanding common shares at an average price of $18.23 ($17.43) per share for a total of $1,487 ($2,578) 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 2011 (2010), the Company issued 22,888 (31,661) shares under the ESPP at an average price of $14.06 ($10.87) and employees subscribed to approximately 24,627 common shares, which will be issued during fiscal 2012 at an average price of $14.81. Since inception and including the issuance of shares in 2011, 320,438 shares have been issued under the plan. During 2011 (2010), the Company recorded compensation expense of $68 ($61) relating to its ESPP.

Contributed surplus:

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Balance, beginning of year | $ | 171 | $ | 285 |
| Stock option compensation | | 69 | | 20 |
| Options exercised | | (21) | | (134) |
| Balance, end of year | $ | 219 | $ | 171 |

## 11. 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 345,000 options have been issued at September 30, 2011.

During 2011, the Company granted 95,000 options to directors and officers at a price of $18.65 per share with 28,000 vesting immediately and 67,000 options vesting over a period of two years. The options expire on February 14, 2016. 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 2011 was $1.27 per option and was calculated using the Black-Scholes option pricing model using the following weighted average assumptions:

| | |
|---|---|
| Risk free interest rate | 1.8% |
| Expected dividend yield | 5.5% |
| Stock price volatility | 17.7% |
| Expected life of options | 2.91 years |

## 11. Stock Options (Continued)

Options outstanding:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Options | Weighted Avg. Exercise Price | Options | Weighted Avg. Exercise Price |
| Outstanding, beginning of year | 76,800 | $ 11.71 | 155,438 | $ 11.22 |
| Exercised | (21,800) | $ 9.05 | (78,638) | $ 10.74 |
| Granted | 95,000 | $ 18.65 | - | $ - |
| Outstanding, end of year | 150,000 | $ 16.49 | 76,800 | $ 11.71 |

| | Range of exercise prices | | | |
|---|---|---|---|---|
| | $9.05 | $13.00 - $13.47 | $18.65 | TOTAL |
| Options outstanding at September 30, 2011 | 5,000 | 50,000 | 95,000 | 150,000 |
| Weighted average exercise price | $9.05 | $13.14 | $18.65 | $16.49 |
| Weighted average remaining life | 2.1 years | 0.6 years | 4.4 years | 3.1 years |
| Options exercisable at September 30, 2011 | 5,000 | 50,000 | 40,000 | 95,000 |
| Weighted average exercise price | $9.05 | $13.14 | $18.65 | $15.25 |

## 12. Earnings Per Share

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

| | 2011 | 2010 |
|---|---|---|
| Weighted average number of common shares – basic | 7,697,217 | 7,756,584 |
| Additions to reflect the dilutive effect of employee stock options | 17,948 | 34,241 |
| Weighted average number of common shares – diluted | 7,715,165 | 7,790,825 |

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 2011 (2010), 95,000 (Nil) options were excluded from the above computation of diluted weighted average number of common shares because they were anti-dilutive.

## 13. Interest Income

Interest income is comprised of the following amounts:

| | 2011 | 2010 |
|---|---|---|
| Interest earned on cash balances | $ 301 | $ 193 |
| Interest earned on investment | 36 | - |
| Accreted interest on host contract component of investment | 480 | 560 |
| Interest income | $ 817 | $ 753 |

## 14. 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:

| | |
|---|---|
| 2012 | $ 2,433 |
| 2013 | 2,229 |
| 2014 | 2,177 |
| 2015 | 2,177 |
| 2016 | 2,177 |
| Thereafter | 1,209 |
| Total | $ 12,402 |

## 15. 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.

## 16. 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.

## 17. 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.

## 18. 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' work-forces 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, 2011**

| | Systems Engineering | Business and Technology Services | Corporate | Total |
|---|---|---|---|---|
| Revenues | $ 65,716 | $ 160,935 | $ - | $ 226,651 |
| Operating expenses | 54,852 | 150,660 | 2,565 | 208,077 |
| Depreciation and amortization | 607 | 521 | - | 1,128 |
| Earnings before interest income and income tax expense | $ 10,257 | $ 9,754 | $ (2,565) | $ 17,446 |
| Interest income (Note 13) | | | | 817 |
| Income tax expense (Note 6) | | | | (5,082) |
| Net earnings | | | | $ 13,181 |
| | | | | |
| Total assets other than cash and goodwill | $ 16,257 | $ 33,962 | $ 113 | $ 50,332 |
| Goodwill | - | 9,518 | - | 9,518 |
| Cash | - | - | 30,742 | 30,742 |
| Total assets | $ 16,257 | $ 43,480 | $ 30,855 | $ 90,592 |
| Equipment and intangible expenditures | $ 352 | $ 131 | $ - | $ 483 |

## 18. Segmented Information (Continued)

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

| | Systems Engineering | Business and Technology Services | Corporate | Total |
|---|---|---|---|---|
| Revenues | $ 64,000 | $ 151,725 | $ - | $ 215,725 |
| Operating expenses | 52,305 | 141,290 | 2,553 | 196,148 |
| Depreciation and amortization | 492 | 452 | - | 944 |
| Earnings before 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 7) | | | | (52) |
| Interest income (Note 13) | | | | 753 |
| Income tax expense (Note 6) | | | | (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 |

Revenues from external customers are attributed as follows:

| | 2011 | 2010 |
|---|---|---|
| Canada | 78% | 77% |
| United States | 12% | 13% |
| Europe | 10% | 10% |

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, 2011 represent 61% (2010: 64%) of the Company's total revenues. Both operating segments conduct business with this major customer.

## 19. 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.

## 19. Financial Instruments and Risk Management (Continued)

*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, 2011, the Company had the following forward foreign exchange contracts:

| Type | Notional | Currency | Maturity | Equivalent Cdn. Dollars | Fair Value September 30, 2011 |
|---|---|---|---|---|---|
| BUY | 14,295 | USD | October 2011 | $ 14,613 | $ 371 |
| SELL | 1,000 | USD | September 2015 | 1,057 | 9 |
| SELL | 1,000 | USD | September 2016 | 1,057 | 9 |
| SELL | 1,000 | USD | September 2017 | 1,057 | 9 |
| BUY | 3,829 | EURO | October 2011 | 5,329 | 48 |
| BUY | 167 | GPB | October 2011 | 268 | 5 |
| Derivative assets | | | | | $ 451 |
| SELL | 35,703 | USD | October 2011 | 36,497 | 927 |
| SELL | 10,249 | EURO | October 2011 | 14,265 | 127 |
| Derivative liabilities | | | | | $ 1,054 |

## 19. Financial Instruments and Risk Management (Continued)

At September 30, 2010, the Company had the following forward foreign exchange contracts:

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

A 10% strengthening (weakening) of the Canadian dollar against the following currency at September 30, 2011 would have increased (decreased) other comprehensive income as related to the forward foreign exchange contracts by the amounts shown below.

| | 2011 |
|---|---|
| USD | $ 2,272 |
| EURO | 927 |
| GBP | (26) |
| | $ 3,173 |

*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, 2011 the net investment in the US-based subsidiary was $981. A 10% strengthening (weakening) of the Canadian dollar against the US dollar at September 30, 2011 would have decreased (increased) OCI by $98.

### 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, 2011, 71% 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.

## 19. Financial Instruments and Risk Management (Continued)

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.

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

| | 2011 | 2010 |
|---|---|---|
| Cash | $ 30,742 | $ 29,055 |
| Accounts receivable | 35,181 | 33,954 |
| Derivative assets | 451 | 158 |
| Investment | - | 3,417 |
| | $ 66,374 | $ 66,584 |

The aging of accounts receivable at the reporting date was:

| | 2011 | 2010 |
|---|---|---|
| Current | $ 34,246 | $ 33,072 |
| Past due (61-120 days) | 833 | 701 |
| Past due (> 120 days) | 102 | 181 |
| | $ 35,181 | $ 33,954 |

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, 2011 the Company has a cash balance of $30,742 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, 2011 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, 2011.

## 19. 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).

| | 2011 Level 1 | 2011 Level 2 |
|---|---|---|
| Cash | $ 30,742 | $ - |
| Derivative financial assets | - | 451 |
| Derivative financial liabilities | - | (1,054) |
| Total | $ 30,742 | $ (603) |

| | 2010 Level 1 | 2010 Level 2 |
|---|---|---|
| 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 periods ending September 30, 2010 and 2011.

## 20. Pension Plan

The Company sponsors a defined contribution pension plan for certain of its employees. Required contributions have been fully funded to September 30, 2011. For the year 2011 (2010), an amount of $687 ($708) was expensed related to this pension plan.

# Corporate Information

## Corporate & Business and Technology Services

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Web: www.sedsystems.ca

## United States Office

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Phone: 703.392.4950
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## 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

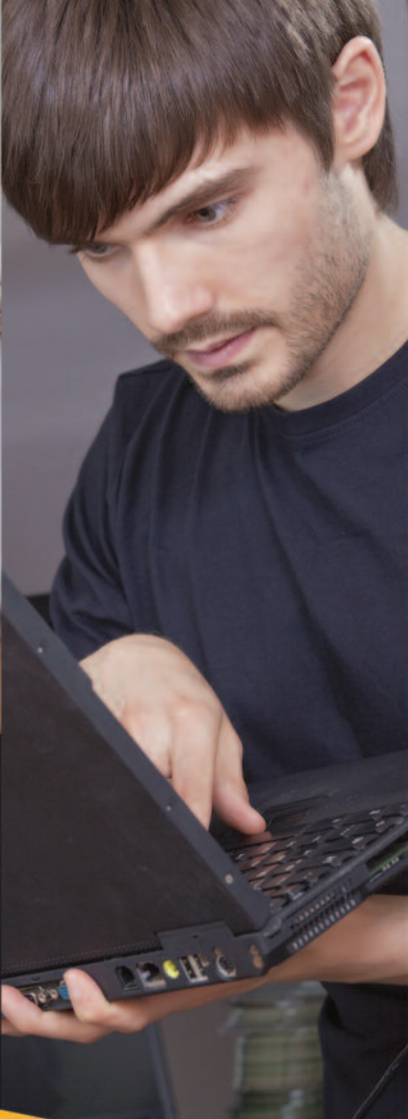
The Company's common shares are listed for trading on the Toronto Stock Exchange under the symbol CTY.

## 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 10, 2012 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.



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Annual Report

Calian Technologies Ltd.