AVCORP

annual report 2008

ABOUT AVCORP INDUSTRIES INC. Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including Boeing, Bombardier, and Cessna. With more than 50 years of experience, 550 skilled employees and 354,000 square feet of facilities, Avcorp offers integrated composite and metallic aircraft structures to aircraft manufacturers, a distinct advantage in the pursuit of contracts for new aircraft designs, which require lower-cost, light-weight, strong, reliable structures. Avcorp is a Canadian public company traded on the Toronto Stock Exchange (TSX:AVP).

management discussion & analysis

This Management Discussion and Analysis has been prepared as of March 25, 2009, and should be read in conjunction with the Company's financial statements and notes thereto for the year ended December 31, 2008.

Description of Business

Avcorp Industries Inc. (the Company) supplies major airframe structures to aircraft manufacturers and to their suppliers. Our capabilities are product design, tool design, parts fabrication, assembly and repair, all of which are governed by strong program management.

We operate from two locations in Canada, one dedicated to composites, the other dedicated to light weight metal manufacturing.

Avcorp is in compliance with Industry Standard Quality requirements.

Financial Overview

Three-Year Results

The following table provides selected financial information for the three years to December 31, 2008.

THREE-YEAR RESULTS

unaudited, prepared in accordance with Canadian GAAP, expressed in thousands of Canadian dollars except per share amounts, ratios and shares outstanding

For the year ended December 31	2008	2007	2006
OPERATIONS			
Revenues	**$ 128,868**	$ 110,283	$ 103,850
EBITDA[1,2]	**6,410**	4,155	7,003
Operating income (loss) before tax	**485**	205	3,483
Net income (loss)	**(2,251)**	(1,719)	1,450
Basic income (loss) per share	**(0.07)**	(0.06)	0.06
Diluted income (loss) per share	**(0.07)**	(0.06)	0.06
FINANCIAL POSITION			
Net capital expenditures	**2,771**	5,020	2,111
Total assets	**60,990**	60,304	48,617
Bank indebtedness and long-term debt	**23,418**	20,096	11,258
Shareholders' equity	**16,325**	18,519	18,693
Book value per share	**0.51**	0.59	0.67
Ratio: debt/equity	**1.43**	1.09	0.60
Ratio: current assets/current liabilities	**0.94**	1.16	1.48
Shares outstanding at period end	**32,315**	31,445	27,837

1. EBITDA = earnings before interest, taxes, depreciation and amortization
2. EBITDA is not a recognized term under Canadian generally accepted accounting principles (GAAP)

Quarterly Results

The following table provides selected quarterly financial information for the eight most recent fiscal quarters to December 31, 2008.

QUARTERLY RESULTS

unaudited, prepared in accordance with Canadian GAAP, expressed in thousands of Canadian dollars except per share amounts

	2008				2007			
For the three months ended	**Dec 31**	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	**$34,434**	$30,894	$32,389	$31,151	$26,878	$26,696	$29,352	$27,357
Income (loss) from operations	**(1,561)**	1,004	859	183	(1,857)	628	859	575
EBITDA[1,2]	**1,141**	1,676[3]	2,218	1,375	(1,282)	1,500	2,308	1,629
Net income (loss)	**(1,972)**	(220)[3]	364	(423)	(2,943)	32	817	375
EBITDA per share[1,2]								
Basic	**0.04**	0.05[3]	0.07	0.04	(0.04)	0.05	0.08	0.06
Diluted	**0.04**	0.05[3]	0.07	0.04	(0.04)	0.04	0.07	0.05
Net income (loss) per share								
Basic	**(0.06)**	(0.01)[3]	0.01	(0.01)	(0.10)	0.00	0.03	0.01
Diluted	**(0.06)**	(0.01)[3]	0.01	(0.01)	(0.10)	0.00	0.02	0.01
Long-term debt	**2,872**[4]	7,192	7,424	6,306	6,761	6,419	5,064	5,041

1. EBITDA = earnings before interest, taxes, depreciation and amortization
2. EBITDA is not a recognized term under GAAP
3. Inclusive of $759,000 write-down of investment (note 9 to the consolidated financial statements)
4. Exclusive of $4,097,000 convertible debenture held by Export Development Canada classified as current portion of long-term debt due for repayment on December 31, 2009 (note 14a and 27c to the financial statements)

2008 and 2007 Results Overview

During the year ended December 31, 2008, the Company recorded earnings from operations of $485,000 on $128,868,000 revenue, an improvement over the $205,000 earnings from operations on $110,283,000 revenue for the preceding year; and a net loss for the current year of $2,251,000 as compared to a net loss of $1,719,000 for the year ended December 31, 2007.

The following three significant non-recurring charges against income were recorded in 2008:

- As at September 30, 2008, management estimated that there was an other than temporary decline in value of the Company's investment in Eclipse Aviation Corporation. Accordingly, the investment has been written down to $Nil (note 9 to the financial statements). This non-cash write-down had the impact of reducing net income by $759,000.

- Fourth quarter 2008 softening of customers' order book has caused the Company to review operations and terminate employees. This has necessitated a $607,000 charge against income in the year ended December 31, 2008.

- On December 31, 2008, management estimated that there existed an impairment on the goodwill which arose from the acquisition of Comtek Advanced Structures Ltd., accordingly a $571,000 impairment loss was recognized.

Continued strong improvements in operational efficiencies during 2008 have contributed to the Company reducing its previously recorded provision for loss making contracts, thereby increasing net income by $497,000 (2007: $1,039,000 decrease to net income). Income from unrealized derivative gains amounted to $502,000 for the year ended December 31, 2008 as compared to a gain of $170,000 for the preceding year. Foreign exchange losses for the current year totalled $2,349,000 (2007: $1,321,000 gain) resulting from holding a net US dollar liability position during a period having a rapid devaluation in the Canadian dollar capital surplus relative to the US dollar.

Cash flows from operating activities provided $5,412,000 of cash, as compared to $3,071,000 during 2007. The Company has a working capital deficit of $2,065,000 as at December 31, 2008 (December 31, 2007: $4,417,000) primarily as a result of classifying the $4,097,000 convertible debenture held by Export Development Canada as current portion of long-term debt (note 14a and 27c to the financial statements), and an accumulated deficit of $56,213,000 at December 31, 2008 (December 31, 2007: $53,204,000).

The Company has two operating lines of credit, which have a total maximum availability of $22,000,000. $2,000,000 of this total has been apportioned to Comtek Advanced Structures Ltd. The remaining $20,000,000 operating line of credit has the following terms and conditions (note 11 to the financial statements):

- borrowing in excess of $15,000,000 up to $20,000,000 will be cash secured (utilized $14,273,000 as at December 31, 2008; utilized $11,279,000 as at December 31, 2007);
- interest at prime plus 0.875%, 1.00%, 1.175%, or 1.25% determined on a quarterly basis according to specific measures of the ratio of debt to tangible net worth;
- US dollar sub-limit for the operating line of credit is USD$15,000,000; and
- foreign forward exchange facility having a notional risk for credit purposes of $3,528,000 to purchase foreign forward exchange contracts for major currencies, with a maximum maturity of 12 months.

During the year ended December 31, 2008, holders of warrants exercised a total of 675,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 244,660 common shares at a price of $0.90, for gross proceeds of $220,000. The remaining 430,340 common shares issued at a price of $0.90 amounting to $387,000 were used to pay amounts owing.

Also during 2008, holders of options exercised a total of 166,634 share purchase options resulting in the issuance of 166,634 common shares at a price of $0.90 per share, for total gross proceeds of $150,000.

A holder of preferred shares converted 5,000 preferred shares resulting in the issuance of 28,571 common shares at $1.75 per share.

Going Concern

As at December 31, 2008, the Company was not in compliance with its working capital covenant associated with its operating line of credit. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009. The Company has not obtained a waiver from the debt holder for this non-compliance and for anticipated future breaches. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment (note 11 to the financial statements).

Also, as at December 31, 2008, the Company was not in compliance with its working capital and debt service coverage covenants associated with the convertible debenture held by Export Development Canada (note 14a to the financial statements). The Company has not obtained a waiver from the debenture holder for these non-compliances and for anticipated future breaches. On March 13, 2009, Export Development Canada served notice to the Company requiring that if the non-compliances are not rectified within 60 days of the notice date, all balances shall become payable on demand. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment. The Company is currently negotiating the terms of repayment with Export Development Canada (note 27c to the financial statements).

In 2009, the Company will be required to seek amendments of its borrowing terms to either waive any breaches, or modify the covenants. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage.

The Company forecasts its financing requirements for 2009 and 2010 to exceed the current availability of the operating line of credit. Accordingly, the Company plans to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and manage customer payments to existing terms in order to provide liquidity in excess of forecasted requirements. The Company expects to finance investment in the start-up of new military defence programs with milestone payments from customers. However, success of these activities cannot be assured.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The conditions and risks noted above cast significant doubt on the validity of that assumption.

These consolidated financial statements do not reflect adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and balance sheet classifications used that would be necessary if the going concern assumption were not appropriate; such adjustments could be material.

Revenue

Revenue for the year ended December 31, 2008 was $128,868,000 (December 31, 2007: $110,283,000). Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

unaudited, prepared in accordance with Canadian GAAP, expressed in thousands of Canadian dollars

For the year ended December 31	**2008**		2007	
	Revenue	**% of Total**	Revenue	% of Total
Boeing	**$ 18,518**	**14.4**	$ 19,327	17.5
Bombardier	**28,760**	**22.3**	24,025	21.8
Cessna	**64,710**	**50.2**	57,666	52.3
Other	**16,880**	**13.1**	9,265	8.4
Total	**128,868**	**100.0**	110,283	100.0

$14,469,000 of the Company's growth in revenue during the current year, relative to 2007, was from the consolidation of the operations of Comtek Advanced Structures Ltd. (Comtek). Consolidation of Comtek operations during 2008 has provided most of the growth in revenues from other customers. This acquisition has resulted in diversification of the Company's revenue base into composite parts for Airbus A380 commercial jet components, as well as smaller composite structures' after-market sales and repairs.

The remaining increase in revenues was attributable to a sales mix having a greater proportion of high value assemblies. Boeing Commercial Airplane Group (Boeing), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna) continued to be the Company's three major customers.

New statements of work with Boeing were not sufficient to offset the 7% reduction in the shipments of larger assemblies for the 737 aircraft. The leading cause for the decrease in sales to this customer over those for the same period last year was work stoppages at Boeing. The primary source of revenue from Boeing is from the 737 aircraft. During 2008, the Company commenced its planned diversification into military work which will consist of deliveries of components to Boeing Integrated Defense Systems for the CH47 helicopter. The Company expects to achieve full rates of production parts for this program during 2009, with the intent to deliver larger assembled structures in 2010. The Company continues to work towards obtaining additional new contracts supporting 737, 747, 767, 777 and 787 commercial jet programs.

Deliveries to Bombardier increased for all of the Challenger business jet programs during the current year relative to the year ended December 31, 2007, with the exception of the CRJ700 regional jet programs. Bombardier's termination for convenience of the CRJ700 regional jet program caused a $7,479,000 reduction in revenues for 2008 relative to 2007. A termination claim has been presented to Bombardier for its cessation of the CRJ700 regional jet program with the Company; its resolution is currently being negotiated. The net increase for 2008 revenues from Bombardier was attributable to a 46% increase in deliveries of large assemblies for the Challenger business jet programs. The Company's primary source of revenues from Bombardier in 2009 will continue to be from components on the CL605 and CL850 business jets, and with the addition of composite floor boards for the CRJ and Q400 aircraft programs. In connection with existing floor board deliveries, the Company is currently negotiating a settlement on overpayment of royalties to Bombardier.

Deliveries of major structures to Cessna increased by 12% in 2008, relative to 2007. The primary sources of revenue from Cessna are from deliveries of components for the Citation Sovereign business jet whose deliveries increased by 18% in 2008 and the Citation CJ3 business jet for which deliveries fell by 3% in 2008 relative to 2007. A continuation of deliveries for components of these aircraft is expected to comprise the majority of revenues from Cessna for 2009, while the ramp-up of deliveries for the Citation CJ4 business jet components occurs.

Non-recurring revenues amounting to $1,162,000 arising from program support for the Honda Aircraft Company Inc. (Honda) HondaJet business jet, in preparation for program production unit deliveries in 2009 and beyond, also contributed to business growth.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2008 was 16.8% of revenue as compared to 10.7% of revenue for the year ended December 31, 2007. This represents the highest gross profit percentage during this decade.

Continued strong operational performance improvements in assembly and fabrication lines have reduced unit production hours on average by 9%; with one large assembly program achieving a 17% reduction in production hours.

The net reduction in average unit material costs amounted to 3% which was as a result of a stronger Canadian dollar against the US dollar, offset by some increases in the cost of materials and outside purchases.

The operational performance improvements have allowed the Company to reverse $497,000 of its provision for expected future losses on certain programs. There remains recorded a $564,000 provision for loss-making programs as at December 31, 2008.

Administration and General Expenses

As a percentage of revenue, administration and general expenses increased from 8.7% for the year ended December 31, 2007 to 10.6% for 2008. Administrative and general expenses have increased for the year ended December 31, 2008 relative to last year, primarily due to research and development expenditures incurred by Comtek. Administrative and general expense includes a charge against income for $607,000 in year-end severance expenses.

Foreign Exchange Gain

The Company recorded a $2,349,000 foreign exchange loss during 2008 (December 31, 2007: $1,321,000 gain) as a result of holding foreign-currency-denominated receivables, payables and debt.

Other Income

The Company uses derivative financial instruments to reduce its exposure to foreign currency and price risk associated with its revenues and costs of certain procured items. A $36,000 loss arose during the year ended December 31, 2008, as a result of holding purchase and sales contracts having embedded derivatives; while no gain or loss occurred during 2008 as a result of derivative financial instruments associated with its procurement contracts (note 5 to the financial statements). The Company has USD $25,000,000 of unrealized foreign-exchange-forward contracts as at December 31, 2008 and for which a $538,000 gain has been recorded as at December 31, 2008 (note 5 to the financial statements).

All other financial instruments have been recorded at cost or amortized cost, subject to impairment reviews.

Earnings Before Interest, Taxes, Depreciation & Amortization

Earnings before interest, taxes, depreciation and amortization (EBITDA) were $6,410,000 for the year ended December 31, 2008 compared to $4,155,000 for the year ended December 31, 2007.

EBITDA

unaudited, prepared in accordance with Canadian GAAP, expressed in thousands of Canadian dollars

For the year ended December 31	2008	2007
Income (loss) for the period	**$ (2,251)**	$ (1,719)
Interest expense and financing charges	**2,479**	2,094
Income tax expense	**-**	-
Depreciation	**4,133**	3,395
Amortization of development costs and intangible assets	**2,049**	385
	6,410	4,155

EBITDA is a term that does not have a standardized meaning under Canadian generally accepted accounting principles (GAAP). EBITDA has not been adjusted for the $759,000 write-down of investment (note 9 to the financial statements).

Interest and Financing Charges

Total interest and financing charges on both short- and long-term debt, some to related parties, for the year ended December 31, 2008 was $2,479,000 as compared to $2,094,000 for the previous year. This is a result of periodic higher utilization of the operating line of credit and financing obtained for equipment purchases.

Write-Down of Investment and Goodwill

As at September 30, 2008, management estimated that there was an other than temporary decline in value of the Company's investment in Eclipse Aviation Corporation. Accordingly, the investment has been written-down to $Nil (note 9 to the financial statements). This non-cash write-down had the impact of reducing net income by $759,000.

In comparing the carrying amount of Comtek Advanced Structures Ltd. to its fair value, management estimated that its carrying amount, including goodwill, exceeded its fair value. Accordingly, a goodwill impairment loss of $571,000 has been recognized (note 10 and 26 to the financial statements).

Income Taxes

The Company has not incurred a tax expense during the current year (December 31, 2007: $Nil).

Income

The loss for the year ended December 31, 2008 was $2,251,000 compared to a loss of $1,719,000 for the year ended December 31, 2007. Operational performance has strengthened during the current year over the prior year, as is reflected in the improved gross profit (including a $497,000 reversal of provision for loss-making programs) and strengthened income from operations. However, current year income was adversely affected by the $759,000 non-cash write-down of the Company's investment (note 9 to the financial statements), the $571,000 non-cash impairment loss associated with goodwill (note 10 to the financial statements), foreign exchange losses amounting to $2,349,000 (note 5 to the financial statements) and $607,000 in year-end severance expenses.

Liquidity and Capital Resources

The Company ended the year with bank operating line utilization of $14,273,000 compared to $11,279,000 as at December 31, 2007. Unless secured by cash, the Company's operating lines of credit provide for a total utilization of $17,000,000.

The Company forecasts its financing requirements for 2009 and 2010 to exceed the current availability of the operating line of credit. Accordingly, the Company plans to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and manage customer payments to existing terms in order to provide liquidity in excess of forecasted requirements. The Company expects to finance investment in the start-up of new military defence programs with milestone payments from customers. However, success of these activities cannot be assured.

Cash Flows from Operating Activities

Cash provided from operating activities, before consideration of changes in non-cash items relating to operating activities, was $5,412,000 for the year ended December 31, 2008 compared to cash provided of $3,071,000 for last year. The primary contributor to generation of cash from operating activities was the significant improvement in manufacturing efficiencies.

Non-cash operating assets and liabilities utilized $589,000 (note 21b to the financial statements) of cash during the current year, compared to a utilization of $1,323,000 last year. The 2008 utilization was primarily as a result of increased accounts receivable and inventories from business growth.

Cash Flows from Investing Activities

During the current year, the Company purchased capital assets totalling $2,771,000 as compared to $5,020,000 during the year ended December 31, 2007. The purchases consisted of manufacturing equipment, to augment capacity, capability, and increase operating efficiencies, and a continued upgrading of the information technology infrastructure.

Additionally, the Company invested $2,766,000 (December 31, 2007: $744,000) in tooling and in improving the production efficiencies of various program lines. A significant portion of this expenditure was specifically invested in new product introduction for the Cessna Citation CJ4 business jet program, for which the Company will commence delivering tail assemblies in the second quarter 2009.

Cash Flows from Financing Activities

The Company finances working capital through a combination of bank debt and other financial instruments.

During 2008, the Company’s operating line of credit utilization increased by $2,994,000 (2007: $4,790,000).

For the year ended December 31, 2008, the Company obtained equipment financing in the form of sale and leaseback agreements totalling $1,215,000, and $131,000 from Technology Partnerships Canada. Proceeds from the sale of tooling amounted to $104,000 for the year.

During the current year, the Company repaid $3,342,000 of current and long-term debt consisting of $1,231,000 in equipment financing, $1,049,000 in royalty payments, $359,000 in term loan repayments, and $703,000 in debenture repayments.

Dividends paid on the preferred shares issued on July 10, 2006 amounted to $758,000 (note 17 to the financial statements) for the year ended December 31, 2008.

The Company issued 411,294 common shares on the exercise of warrants and options during the year ended December 31, 2008 for cash proceeds of $370,000 (note 16b to the financial statements).

On December 31, 2008, the ratio of the Company's current assets to current liabilities was 0.94:1 (December 31, 2007: 1.16:1), with the debt to equity ratio at 1.43:1 (December 31, 2007: 1.09:1).

As at December 31, 2008, the Company was not in compliance with its working capital covenant associated with its operating line of credit provided by a Canadian chartered bank (note 11 to the financial statements). The Company has not obtained a waiver from the debt holder for this non-compliance and for anticipated future breaches. Also, as at December 31, 2008, the Company was not in compliance with its working capital and debt service coverage covenants associated with the convertible debenture held by Export Development Canada (note 14a to the financial statements). The Company has not obtained a waiver from the debenture holder for these non-compliances and for anticipated future breaches. On March 13, 2009, Export Development Canada served notice to the Company requiring that if the non-compliances are not rectified within 60 days of the notice date, all balances shall become payable on demand. The Company is currently negotiating the terms of repayment with Export Development Canada (note 27c to the financial statements).

Contractual Obligations

PAYMENTS DUE BY PERIOD

unaudited, prepared in accordance with Canadian GAAP, expressed in thousands of Canadian dollars

	Total	2009	2010 – 2012	2013 – 2014	Post 2014
Convertible debentures	**$ 4,097**	$ 4,097	$ -	$ -	$ -
Capital lease obligation	**4,096**	1,225	2,620	251	-
Purchase obligation[1,2]	**25,533**	2,527	8,167	5,135	9,704
Other long-term obligations[3]	**952**	952	-	-	-
Total contractual obligations	**34,678**	8,801	10,787	5,386	9,704

[1] Purchase obligations include payments for the Company's operating and property leases.
[2] During 2003, the Company entered into a 15-year leaseback agreement with the purchaser of its property. As part of the consideration from the sale of the property, the Company received a $1,500,000 rent credit to be applied to rent in 2008 and 2009.
[3] This amount represents obligations the Company has with Technology Partnership Canada.

The Company expects that payment of contractual obligations will come from funds generated by operations and utilization of the bank operating line of credit.

The Company does not have any off-balance sheet liabilities or transactions that are not recorded or disclosed in the financial statements.

Capital Stock

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, issueable in series, the terms of which will be determined by the Company's directors at the time of creation of each series. There were 32,314,929 common shares issued and 293,713 reserved at December 31, 2008. The book value of common shares issued and outstanding as at December 31, 2008 was $64,916,000.

As at March 25, 2009, there were 32,314,929 common shares, 816,800 preference shares, 1,327,880 warrants and no options issued and outstanding.

Recent Accounting Pronouncements

These consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP).

These consolidated financial statements are prepared following accounting policies consistent with the Company's audited annual consolidated financial statements and notes thereto for the year ended December 31, 2007, except for the following changes in accounting policies. Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants (CICA) standards 1535, 3031, 3862 and 3863.

- Section 1535 – Capital Disclosures: This section requires the Company to disclose its objectives, policies and processes for managing capital (note 4 to the financial statements).
- Section 3031 – Inventories: This section prescribes the accounting treatment for inventories and provides guidance on the determination of cost and subsequent recognition as an expense, including any write-down to net realizable value (note 6 to the financial statements).
- Section 3862 – Financial Instruments Disclosures: This section enhances the disclosure requirements on the nature and extent of risks arising from financial instruments and how the Company manages those risks (note 5 to the financial statements).

- Section 3863 – Financial Instruments Presentation: This section provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instrument related presentation disclosures.

New accounting pronouncements not yet adopted. Effective January 1, 2009, the Company will adopt CICA standard 3064. The Company is considering the effect this standard may have on its financial statements.

- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred.

- Convergence with International Financial Reporting Standards

- In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted accounting principles (Canadian "GAAP"), as used by public companies, being evolved and converged with International Financial Reporting Standards ("IFRS") over a transitional period which will be complete by 2011. As of the date of these consolidated financial statements, the International Accounting Standards Board has projects underway that should result in new pronouncements; accordingly the Company is assessing the impact of the ultimate adoption of IFRS on the Company's consolidated financial statements. Management has reviewed its business systems and determined that they are capable of processing and recording the transitional period reporting requirements. As well, key employees have been trained in the new reporting standards, and a plan for adoption of IFRS is being developed.

Operations Overview

Delivery and Quality Performance

Deliveries as at December 31, 2008 were at planned levels for Cessna, Bombardier and Boeing programs, with the following exceptions.

Some program deliveries to Bombardier were behind planned delivery dates, but not impacting customer requirement, due to short lead time customer schedule changes and plant employee lay-offs. All Bombardier deliveries are on schedule as of the date of this report.

The quality and schedule problems from two specific suppliers which caused deliveries on a Cessna program to fall behind plan earlier in 2008 were corrected by year end.

Inconsistent deliveries of primer paints from a sole-source, customer-stipulated supplier which caused the Company to ship late on certain Boeing programs earlier in 2008 were also corrected by year end.

All other program deliveries were on schedule or not impacting customer requirements.

During 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company has accrued a $1,454,000 discounted charge within cost of sales in 2007. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $1,454,000 recovery was accrued within cost of sales in 2007. During 2008, the Company revised its discounted warranty provision to $1,521,000 and discounted warranty recovery to $1,569,000. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur over a four to five year period.

During 2008, the Company became aware of the requirement to rework product, some of which had been delivered to a customer. A portion of the rework was performed in 2008, with the remaining rework to be completed in 2009. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $215,000 charge within cost of sales in 2008. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $215,000 recovery was accrued within cost of sales. The amounts recorded are based on management's best estimate of the amount of product affected. The claim has been settled with the supplier subsequent to year end for the full amount claimed.

Order Backlog

The Company operates within “general terms agreements” with its customers. These agreements are typically for five years or longer. The Company’s contracts with Boeing extend from January 2007 to December 2011. The Bombardier and Cessna agreements extend for the life of the programs.

The Company defines order backlog as the value of purchase orders it expects to receive from these contracts based on manufacturers’ projections and current degrees of exclusivity. The order backlog, as at the date of this report, was $412 million compared to $478 million as at December 31, 2007, $96 million of which pertains to 2009. The Company has chosen to disclose current rather than December 31, 2008 order backlog values as current values are more appropriately representative. The changes in order backlog are as follows:

- $11 million net increase in order backlog primarily due to production rate decreases of various existing programs (this is a result of a $173 million decrease in order backlog occurring since September 30, 2008 offsetting $184 million order backlog increase during the first three quarters of 2008); and
- $129 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2008; and
- $52 million increase due to a more favourable current USD foreign exchange rate than as at December 31, 2007. Please refer to comments on currency risk.

Supply Chain

Vendor quality performance met targeted levels during the quarter, with the exception of a limited number of vendors which the Company is managing on a day-to-day basis and in some cases with on-site personnel. A material discrepancy was identified during the third quarter 2008. The vendor and customer were appropriately notified, with the vendor assuming responsibility for remediation. The material discrepancy had been corrected as at the date of this report.

The capacity and delivery performance of a limited number of critical vendors continues to be closely monitored to mitigate risks to assembly start dates. Risk mitigation plans have been implemented during the second half of 2008. Hardware pricing continued to place pressure on 2008 cost levels, due to general industry shortages and high demand. The securing of additional long-term contracts with key suppliers continues.

Working Capital Utilization

As at December 31, 2008 working capital, defined as cash plus accounts receivable and inventories less current bank financing and accounts payable amounted to $1,701,000, as compared to $3,934,000 as at December 31, 2007. It should be noted that this is not a recognized term under Canadian generally accepted accounting principles. Total current assets less total current liabilities was in a deficit position of $2,065,000 at December 31, 2008 and a surplus of $4,417,000 at December 31, 2007. The change in position during 2008 was primarily due to the classification as current debt the $4,097,000 convertible debenture held by Export Development Canada, which is due on December 31, 2009. The Company is currently renegotiating the extension of the repayment terms for this convertible debenture.

Financial Resources

The Company has invested in its chosen strategies of organic growth, lean manufacturing and strategic sourcing. Management believes that the significant investments necessary to better position the Company in the aerospace industry continue to be made, and that those investments along with the expected continued financial support of shareholders and lenders has positioned the Company to be able to face and mitigate risks associated with the business.

Non-Financial Resources

The Company’s non-financial resources relate to the Company’s human resources, operating equipment, systems, technologies and processes. The Company does not have any extended enterprise relationships such as special purpose entities or joint ventures.

Human Resources

The Company has the appropriate human resources at all levels of the organization. The board of directors has considerable aerospace industry, investment, and financial expertise. The management team is experienced in the industry and in all aspects of operations.

The number of employees at December 31, 2008 was 739 (December 31, 2007: 766). Employees have appropriate qualifications and experience to perform their duties and the Company provides ongoing training and opportunities for employee growth.

Equipment, Systems, Technologies and Processes

A select number of internal projects are underway, with the aim of further increasing productivity to desired levels.

Technology upgrades in high-speed machining have occurred in 2008 and are continuing into 2009. These investments were made to mitigate supply chain delivery risk, provide machining capacity for new programs, and bring currently out-sourced work in-house, thereby reducing costs and capturing margin currently in supplier prices.

Information technology assets have been consistently upgraded and further deployed, increasing reliability and utility.

Risk Assessment

The principal risks that the Company faces are summarized as follows:

- significant increases in material costs, primarily aluminum plate, titanium and assembly hardware, and subcontractor costs, without equivalent price protection in customer contracts;
- reduction in production rates of aircraft manufacturers and delays in program introduction;
- actions and globalization by competitors;
- potential failure to achieve cost-reduction objectives relative to revenue growth; and
- the trend to greater use of composite material in primary structures in each new generation of aircraft.

The Company’s view is that, with its financial structure, acquisition of a composite manufacturer and strategic plan in place, the Company is in a position to face and mitigate these risks. However, there can be no assurance that the Company will be successful with all initiatives.

Procured Materials and Parts

Delivery delays on raw materials, in particular aluminum plate and machined components, have been partially mitigated by continued efforts with dual sourcing. The Company has increased safety stocks of primer paint in order to mitigate the risk of inconsistent deliveries. Also continuing efforts are being undertaken to utilize customer relationships to reduce or minimize the increase in cost of bought-in materials and parts as well as ensure delivery commitments.

Aircraft Production Rates

The following industry and program trends impact the Company.

- Industry research indicates that the aerostructures market for commercial aircraft and business jets is shrinking through 2010; the market for defence aircraft however is expected to continue to grow through 2010.
- Boeing has indicated that the rates on the 737 could be reduced by as much as 10% in 2010, while the introduction of the passenger version of the 747-8 is being delayed.
- The production rate on the Boeing 757-200 wing adapter plug for winglet retrofits is tapering off in 2009, partially offset with the introduction of the Boeing 757-300 wing adapter plug variant.
- Bombardier Challenger 850 and the Challenger 605 business jet aircraft production are forecasted to decrease in 2009 and remain flat into 2010.

- Cessna Citation Sovereign and CJ3 business jet rates have decreased significantly for 2009 compared to 2008, and it is expected that these levels will be maintained into 2010. The introduction of the CJ4 is progressing as planned showing continuous growth into 2010.
- Offset opportunities created by the procurement within military aerospace programs by the Canadian government, exist to provide additional revenue from this aerospace sector.

Competitors

Despite the current economic conditions the long-term trend is still to more intense competition from larger entities in Asia and Europe, while original equipment manufacturers (OEM) continue to increase the size and amount of outsourced components. It can be expected that consolidation on Tier 1 and Tier 2 levels will continue to take place. The Company continues to examine opportunities for mergers or acquisitions, on a global basis, that would improve competitiveness and acquire vertical strengths or additional strategic capabilities.

Cost Reductions

Approximately 54% of the Company's cost of sales is related to labour and overhead and 46% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its Western European and US competitors and higher than those in Asia, Eastern Europe and Mexico. The Company's collective agreement with its labour force expires on September 30, 2009. Management is currently preparing for the negotiation of the successor agreement.

The Company continues to focus on cost reductions for direct labour, material and overhead. These reductions will be achieved through a reduction of internal and external supply chain parts shortages, continued negotiation of long-term agreements for 50% of key suppliers, increased plant capacity augmented by technological improvements, and continued focus on cost targets at all levels of the organization. Significant reductions in the direct labour force, staff and management have been undertaken in advance of anticipated reductions in aircraft production rates for 2009. The number of employees has been reduced by 26% since December 31, 2008. Production related material and shop supply costs have been reduced proportionately with anticipated program delivery reductions. Facilities are being consolidated in order to increase utilization and reduce overhead costs. All discretionary spending is being reviewed and controlled by senior management, with expenditures focused on expediting new commercial program business growth and launching of long-term defence programs.

Composite Materials

The December 31, 2007 acquisition of Comtek adds ongoing operations expertise in the design and competitive manufacture of advanced composite aerostructures which provides the opportunity for the Company to compete in a market which is trending, with each new generation of aircraft, to greater use of composite material in primary structures.

Outlook

Current economic conditions have caused the Company's current order backlog to decline during the fourth quarter 2008 and into the first quarter 2009. The Company continues to work towards securing additional defence programs in order to augment and diversify its backlog. Cessna will continue to be the Company's largest customer in 2009, followed by Boeing and Bombardier.

The Company revised its 2009 operating plans as a result of the forecasted 25% reduction in revenues, relative to 2008, which is as a result of the market deferral of business jet deliveries. With the exception of capital expenditures required for new programs and those which have already been contracted with suppliers, the Company's investment in new equipment will be reduced to pre-2008 levels. As of the date of this report, the Company has reduced the number of its employees by 26%. All suppliers have had their orders deferred to the extent possible in order to reduce inventory levels to that required to support the forecasted reduced level of revenues.

The Company forecasts its financing requirements for 2009 and 2010 to exceed the current availability of the operating line of credit. Accordingly, the Company plans to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and manage customer payments to existing terms in order to provide liquidity in excess of forecasted requirements. The Company expects to finance investment in the start-up of new military defence programs with milestone payments from customers. However, success of these activities cannot be assured.

Transactions with Related Parties

During the year ended December 31, 2005, the Company entered into an agreement with a certain shareholder and director in consideration of mutual agreements with a Canadian chartered bank under which the shareholder and director guarantees the indebtedness of the Company to the Bank limited to $2,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a fee ranging from 5% to 10% on the $2,000,000 limited guarantee calculated on a daily basis. Fees paid to a certain shareholder and director during the year ended December 31, 2008 amounted to $100,000 (December 31, 2007: $58,000). Fees payable to a certain shareholder and director as at December 31, 2008 are $100,000 (December 31, 2007: $75,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $125,000 for the year ended December 31, 2008 (December 31, 2007: $100,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders and directors on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to a certain shareholder and director during the year ended December 31, 2008 amounted to $240,000 (December 31, 2007: $60,000). Fees payable to a certain shareholder and director as at December 31, 2008 are $120,000 (December 31, 2007: $180,000). These fees are included in the Statements of Operations as cost of sales and amount to $180,000 for the year ended December 31, 2008 (December 31, 2007: $240,000).

During the year ended December 31, 2008, consulting services were provided by certain directors. Fees paid to certain directors during the year ended December 31, 2008 amounted to $84,000 (December 31, 2007: $10,000). Fees payable to certain directors as at December 31, 2008 are $Nil (December 31, 2007: $47,000). These fees are included in the Statements of Operations as administrative and general expenses and amount to $37,000 for the year ended December 31, 2008 (December 31, 2007: $57,000).

Other related-party transactions are disclosed elsewhere in these financial statements (note 16b and 27b to the financial statements).

These transactions were conducted in the normal course of business and were accounted for at the exchange amount.

Fourth Quarter

The following summarizes financial results for the fourth quarter.

Operating losses for the fourth quarter of 2008 were $1,561,000 from $34,434,000 in revenues, as compared to operating losses of $1,857,000 from $26,878,000 in revenues for the quarter ended December 31, 2007. Major contributing causes to an operating loss for the fourth quarter of 2008 were severance expense in the amount of $607,000, and a $2,955,000 foreign exchange losses arising from holding foreign-currency denominated receivables, payables and debt and a $571,000 write-down of goodwill. EBITDA increased significantly from negative $1,282,000 in the fourth quarter of 2007 to positive EBITDA of $1,141,000 for the same quarter this year. The significant improvement in EBITDA was attributable to a strong 20.5% gross margin for the final quarter in 2008.

Proposed Transactions

As at the date of this report, no agreements to merge with or acquire another entity have been entered into, other than as disclosed elsewhere in the accompanying financial statements.

Critical Accounting Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported revenues and expenses.

The critical accounting estimates the Company has made relate to the following.

- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The December 31, 2008 provision for anticipated losses was $564,000 (December 31, 2007: $1,061,000).

- Unamortized development and tooling costs, net of related government assistance, which reflect the Company's investment in new programs and manufacturing process development, are recorded at $3,299,000 (December 31, 2007: $1,545,000). These costs are to be amortized over the number of units which management believes is a conservative estimate of deliveries for the programs to the customer. Development costs will be written off proportionately to any anticipated reduction in expected unit deliveries to the customer. Current reductions in deliveries have not impacted amortizations over the expected life of these aircraft programs. Furthermore, the Company will write off any amounts of development costs, which it estimates will not be recoverable from the recurring programs to which they relate. At this time, management estimates that all development costs are recoverable.

- An estimation is made of the useful life of equipment. Useful life is measured in terms of years or on a units-of-production basis.

Computer hardware and software	2 - 10 years
Machinery and equipment	5 - 15 years
Leasehold improvements	end of lease, 2018

- An estimation is made of the useful life of intangible assets. Useful life is measured as a range between one and ten years.

- In accordance with Canadian GAAP, the carrying value of goodwill is tested for impairment on an annual basis or when events or circumstances indicate that the related carrying amount may not be recoverable on a reporting unit basis. December 31, 2008, the Company performed its annual impairment test in evaluating goodwill for impairment, estimates of after-tax discounted future cash flows of the Comtek operations were used to estimate the fair value. The cashflow included management's projections of long-term selling prices, operating costs and margin capital expenditures and cost of capital. There are inherent uncertainties related to these factors and management's judgement in applying them to the analysis of goodwill impairment.

  Goodwill was assessed for impairment using a two-step approach. The first step compared the fair value of the reporting unit to its carrying value. The Company performed this test and determined that the fair value of its Comtek unit was less than its carrying values, which required the Company to perform the second step test. This step compared the fair value of Comtek's goodwill to its carrying amount. The Corporation determined that the fair value of goodwill of Comtek was less than the respective goodwill carrying amount, which required the Company to recognize an impairment charge of $571,000 reducing the carrying value of the goodwill to $Nil.

- An estimation is made of the cost of the Company's stock-based compensation and other stock-based payments made in exchange for goods and services. The Company has adopted the Black-Scholes model for its fair value base method of accounting for stock options (note 18 to the financial statements). Option-pricing models require the input of highly subjective assumptions regarding the expected volatility. Changes in assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options at the date of grant.

- On June 17, 2002, the Company acquired 5,264 Series D Preferred Stock of Eclipse Aviation Corporation for $1,527,000. On December 31, 2004, the Company wrote down its investment by $768,000 to its then estimated fair value of $759,000. On September 30, 2008, the Company wrote down its investment by a further $759,000 to an estimated fair value of $Nil.

- During 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $1,454,000 discounted charge within cost of sales in 2007. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $1,454,000 recovery was accrued within cost of sales. During 2008, the Company revised its discounted warranty provision to $1,521,000 and discounted warranty recovery to $1,569,000. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur over a four to five year period.

- During 2008, the Company became aware of the requirement to rework product, some of which had been delivered to a customer. A portion of the rework was performed in 2008, with the remaining rework to be completed in 2009. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $215,000 charge within cost of sales in 2008. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $215,000 recovery was accrued within cost of sales. The amounts recorded are based on management's best estimate of the amount of product affected. The claim has been settled with the supplier subsequent to year end for the full amount claimed.

Financial Instruments and Other Instruments

Interest rate risk

The Company is exposed to interest rate risk on the utilized portion of its $22,000,000 operating line of credit at rates of bank prime plus 0.875%, 1.00%, 1.175% or 1.25% determined on a quarterly basis according to specified measures of the ratio of debt to tangible net worth (note 5 to the financial statements). The Company lowers interest rate costs by managing utilization of the operating line of credit to the lowest amount practical.

For the year ended December 31, 2008, with other variables unchanged, a 1% change in the bank prime interest rate would have a $143,000 impact on net earnings or cash.

The Company primarily finances the purchase of long-lived assets at fixed interest rates.

Currency risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange loss recorded in 2008 was $2,349,000 as compared to a $1,321,000 gain for the year ended December 31, 2007. The Company used derivative financial instruments to mitigate its exposure to currency risks in 2008 and 2007 (note 5 to the financial statements).

As at the balance sheet date, the Company had the following US dollar denominated balances:

Accounts receivable	$ 6,585,000
Bank indebtedness	19,514,000
Accounts payable	4,835,000
Long-term debt	2,431,000

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in a (decrease) increase of approximately $2,020,000 in net earnings for the year ended December 31, 2008.

Other Items

Disclosure Controls and Procedures, and Internal Controls over Financial Reporting

In accordance with the Canadian Securities Administrators Multilateral Instrument 52-109, the Company has filed certificates signed by the Chief Executive Officer and the Head Financial Officer that, among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting. These certificates can be found on www.sedar.com.

The Chief Executive Officer and the Vice President, Finance, have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of December 31, 2008 and concluded that the Company's current disclosure controls and procedures are effective. There were therefore no changes to the Company's disclosure controls and procedures, or in the design of internal controls over financial reporting, during the year ended December 31, 2008, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

This management discussion and analysis should be read in conjunction with the Company's audited financial statements. Certain statements in this report and other oral and written statements made by the Company from time to time are forward-looking statements, including those that discuss strategies, goals, outlook or other non-historical matters; or projected revenues, income, returns or other financial measures. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements, including the following: (a) the extent to which the Company is able to achieve savings from its restructuring plans; (b) uncertainty in estimating the amount and timing of restructuring charges and related costs; (c) changes in worldwide economic and political conditions that impact interest and foreign exchange rates; (d) the occurrence of work stoppages and strikes at key facilities of the Company or the Company's customers or suppliers; (e) government funding and program approvals affecting products being developed or sold under government programs; (f) cost and delivery performance under various program and development contracts; (g) the adequacy of cost estimates for various customer care programs including servicing warranties; (h) the ability to control costs and successful implementation of various cost reduction programs; (i) the timing of certifications of new aircraft products; (j) the occurrence of further downturns in customer markets to which the Company products are sold or supplied or where the Company offers financing; (k) changes in aircraft delivery schedules or cancellation of orders; (l) the Company's ability to offset, through cost reductions, raw material price increases and pricing pressure brought by original equipment manufacturer customers; (m) the availability and cost of insurance; (n) the Company's ability to maintain portfolio credit quality; (o) the Company's access to debt financing at competitive rates; and (p) uncertainty in estimating contingent liabilities and establishing reserves tailored to address such contingencies.

report of management

The accompanying financial statements of Avcorp Industries Inc. and all other information contained in the Management Discussion and Analysis are the responsibility of management. The financial statements were prepared in conformity with Canadian generally accepted accounting principles appropriate in the circumstances, in a manner consistent with the previous year, and include some amounts based on management's best judgments and estimates. The financial information contained elsewhere in this Management Report and Analysis is consistent with that in the financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance. As of the end of the period covered by this report, management provides reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with GAAP. During the period covered by this report, there has been no change in internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

	EDWARD M. MERLO Vice President, Finance and Corporate Secretary		**MARK VAN ROOIJ** Chief Executive Officer

report of auditors

To the Shareholders of Avcorp Industries Inc.

We have audited the consolidated balance sheets of **Avcorp Industries Inc**. as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive loss, deficit and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for each of the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP	**PRICEWATERHOUSECOOPERS LLP** Chartered Accountants

Vancouver, British Columbia
March 25, 2009

Consolidated Balance Sheets

as at December 31, 2008 and December 31, 2007 (in thousands of Canadian dollars)

For the year ended December 31	2008	2007
Assets		
Current assets		
Accounts receivable	**$ 12,609**	$ 12,224
Inventories (note 6)	**19,206**	17,801
Prepayments (note 13)	**1,761**	2,401
Other assets (note 5)	**746**	138
	34,322	32,564
Prepaid rent (note 13)	**-**	481
Development costs (note 7)	**3,299**	1,545
Property, plant and equipment (note 8)	**19,431**	20,310
Investment (note 9)	**-**	759
Warranty claim receivable (note 22c, 22d)	**1,784**	1,454
Intangible assets (note 10)	**2,154**	2,620
Goodwill (note 10, 26)	**-**	571
	60,990	60,304
Liabilities		
Current liabilities		
Bank indebtedness (note 11)	**14,273**	11,279
Accounts payable and accrued liabilities	**15,841**	14,812
Current portion of long-term debt (note 14)	**6,273**	2,056
	36,387	28,147
Deferred gain	**453**	501
Lease inducement (note 13)	**962**	1,060
Deferred tooling revenues (note 12)	**1,173**	2,676
Long-term debt (note 14)	**2,872**	6,761
Warranty provision (note 22c, 22d)	**1,632**	1,454
Future income tax liability (note 23, 26)	**1,186**	1,186
	44,665	41,785
Shareholders' Equity		
Capital stock (note 16)	**62,269**	61,194
Preferred shares (note 17)	**7,622**	7,672
Contributed surplus (note 16e)	**2,647**	2,857
Deficit	**(56,213)**	(53,204)
	16,325	18,519
	60,990	60,304

Nature of operations and going concern (note 1)
Commitments (note 15)
Contingencies (note 22)
Subsequent events (note 22d, 27)

Approved by the Board of Directors

Michael C. Scholz
Chairman

Earnest Beaudin
Committee Chair,
Audit & Corporate Governance Committee

Consolidated Statements of Operations and Comprehensive Loss
For the years ended December 31, 2008 and 2007
(in thousands of Canadian dollars, except number of shares and per share amounts)

For the year ended December 31	**2008**	2007
Revenues	**$ 128,868**	$ 110,283
Cost of sales and expenses		
Cost of sales	**107,188**	98,442
Administrative and general expenses	**13,676**	9,562
Amortization and depreciation (note 2, 8, 10)	**4,599**	3,395
Write-down of goodwill (note 10, 26)	**571**	-
Foreign exchange (gain) loss (note 5)	**2,349**	(1,321)
	128,383	110,078
Income from operations	**485**	205
Interest expense and financing charges (note 20)	**(2,479)**	(2,094)
Unrealized derivative gain (note 5)	**502**	170
Write-down of investment (note 9)	**(759)**	-
Loss and comprehensive loss for the year	**(2,251)**	(1,719)
Basic and diluted loss per common share	**(0.07)**	(0.06)
Basic and diluted weighted average number of shares outstanding (000's)	**32,143**	29,674

Consolidated Statements of Deficit
For the years ended December 31, 2008 and 2007
(in thousands of Canadian dollars)

For the year ended December 31	**2008**	2007
Deficit – Beginning of year	**$ (53,204)**	$ (50,565)
Loss for the year	**(2,251)**	(1,719)
Preferred share dividends (note 17)	**(758)**	(920)
Deficit – End of year	**(56,213)**	(53,204)

Consolidated Statements of Cash Flows

For the years ended December 31, 2008 and 2007 (in thousands of Canadian dollars)

For the year ended December 31	2008	2007
Cash flows from operating activities		
Loss for the year	$ (2,251)	$ (1,719)
Items not affecting cash (note 21a)	7,663	4,790
	5,412	3,071
Change in non-cash items related to operating activities (note 21b)	(589)	(1,323)
	4,823	1,748
Cash flows from investing activities		
Purchase of property, plant and equipment	(2,771)	(5,020)
Payments relating to development costs and tooling	(2,766)	(744)
Proceeds from sale of property, plant and equipment	-	15
Acquisition of Comtek Advanced Structures Ltd. (note 26)	-	(2,073)
	(5,537)	(7,822)
Cash flows from financing activities		
Net proceeds from bank indebtedness	2,994	4,790
Proceeds from long-term debt	131	858
Proceeds from sale and leaseback of property, plant and equipment	1,215	1,903
Proceeds from sale of tooling	103	-
Repayment of long-term debt	(3,342)	(2,581)
Issue of common shares (note 16)	371	1,680
Issue of warrants (note 16)	-	411
Preferred share dividends (note 17)	(758)	(920)
Share issue expense	-	(67)
	714	6,074
Net change in cash and cash equivalents	-	-
Cash and cash equivalents - Beginning of year	-	-
Cash and cash equivalents - End of year	-	-
Interest paid	1,714	1,244

1 Nature of operations and going concern

The Company is a Canadian-based manufacturer within the aerospace industry, and a single-source supplier for engineering design, manufacture and assembly of subassemblies and complete major structures for aircraft manufacturers.

For the year ended December 31, 2008, the Company recorded a net loss of $2,251,000 on $128,868,000 revenue, as compared to a $1,719,000 net loss from $110,283,000 revenue for 2007. The Company has a working capital deficit of $2,065,000 as at December 31, 2008 (December 31, 2007: $4,417,000 surplus) and an accumulated deficit of $56,213,000 at December 31, 2008 (December 31, 2007: $53,204,000).

As at December 31, 2008, the Company was not in compliance with its working capital covenant associated with its operating lines of credit. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009 (note 11). The Company has not obtained a waiver from the debt holder for either the existing breach as at December 31, 2008 or for anticipated future breaches. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment.

Also, as at December 31, 2008, the Company was not in compliance with its working capital and debt service coverage covenants associated with the convertible debenture held by Export Development Canada (note 14a). The Company has not obtained a waiver from the debenture holder for these non-compliances and for anticipated future breaches. On March 13, 2009, Export Development Canada served notice to the Company requiring that if the non-compliances are not rectified within 60 days of the notice date, all balances shall become payable on demand. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment. The Company is currently negotiating the terms of repayment with Export Development Canada (note 27c).

In 2009, the Company will be required to seek amendments of its borrowing terms to either waive any breaches, or modify the covenants. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The conditions and risks noted above cast significant doubt on the validity of that assumption. The Company forecasts its financing requirements for 2009 to exceed the current availability of the operating line of credit. Accordingly, the Company plans to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and maintain existing terms regarding customer collections in order to provide liquidity in excess of forecasted requirements. However, the success of these activities cannot be assured.

These consolidated financial statements do not reflect adjustments to the carrying value of assets and liabilities, the reported revenues and expenses, and balance sheet classifications used that would be necessary if the going concern assumption were not appropriate; such adjustments could be material.

2 Significant Accounting Policies

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported revenues and expenses during the reporting period. The most significant estimates are related to economic lives of depreciable long-lived assets, impairment assessments, inventory valuation, development costs and warranty related receivables and provisions. Actual results could differ from those estimates.

Principles of consolidation

The consolidated financial statements of the Company include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

Revenue

Revenues from recurring production contracts utilize the completed contract method whereby revenue is recognized when the production of a unit is completed, delivery to the customer occurs or shipment in place is authorized by the customer, ownership is transferred to the customer and there is reasonable assurance of collection.

Stock-based compensation

The fair value method of accounting is used for stock-based awards. Under this method, the compensation cost of options and other stock-based compensation arrangements awarded to employees are estimated at fair value at the grant date and charged to earnings over the vesting period.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are measured using the rates that are expected to apply to taxable income in the periods in which the future income tax liability or asset is expected to be settled or realized. Future income tax assets and liabilities are recognized based on the difference between the tax and accounting value of assets and liabilities and are calculated using the tax rates for the periods in which the differences are expected to reverse.

Future income tax assets are evaluated and if realization is not considered "more likely than not" a valuation allowance is provided. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

Income or loss per common share

Income or loss per common share is calculated based on the weighted average number of shares outstanding during the year. The Company follows the treasury stock method in the calculation of diluted loss per share. Under this method, dilution is calculated based upon the net number of common shares issued, should "in the money" options and warrants be exercised, convertible debt converted, with the proceeds used to repurchase common shares at the average market price in the period. During years when a loss is incurred, the potential shares to be issued from the assumed exercise of options and warrants are not included in the calculation of diluted per share amounts since the result would be anti-dilutive.

Translation of foreign currencies and financial instruments

Monetary assets and liabilities denominated in US dollars are converted into Canadian dollars at the rate of exchange prevailing at the period end. Non-monetary assets and liabilities, revenues and expenses in US dollars are converted into Canadian dollars at rates of exchange prevailing on transaction dates, except for amortization which is converted at historical rates.

Inventories

Raw materials are valued at the lower of cost or net realizable value. The cost of raw materials is determined on a weighted average basis. Work in progress and finished goods are valued at the lower of standard cost (which is calculated to approximate actual costs, and includes raw materials, labour and applicable overheads) or net realizable value.

Research and development costs

Research costs are expensed as incurred. Development costs, currently all tooling, less related government assistance, incurred on long-term programs that meet the criteria for deferral are capitalized and amortized over the number of shipsets management believes is a reasonable estimate of units to be sold for the program.

Government assistance

Government assistance towards research and development expenditures is received from Technology Partnerships Canada. Assistance is repayable by way of royalties only if revenues are generated from specified product sales.

The Company credits government assistance directly to the costs and expenses of the related programs for which the assistance was provided.

Property, plant and equipment

Machinery and equipment are recorded at cost less related government assistance and investment tax credits. Depreciation is calculated using the straight-line method over the following estimated useful lives of the assets. Assets recorded under capital leases are depreciated on the same basis as similar assets owned by the Company.

Computer hardware and software	2 - 10 years
Machinery and equipment	5 - 15 years
Leasehold improvements	end of lease, 2018

Impairment of long-lived assets

Management reviews property, plant and equipment for impairment whenever events or changes in circumstances indicate that an impairment may have occurred. Recoverability is assessed by management comparing the carrying amount to the estimated future net cash flows the assets are expected to generate. Where the carrying value exceeds estimated net cash flows, the assets are written down to their estimated fair value.

Investments

Investments in equity instruments when a market value cannot be determined are classified as available for sale and carried at cost. If management determines there is an other than temporary decline in value, these investments will be written down to net realizable value.

Intangible assets

Intangible assets are comprised of the fair value of customer relationships, order backlog, trade name and patents. The income approach is used to value intangible assets. The fair value of intangible assets acquired in a business combination is assigned a portion of the total cost of the purchase based on their fair values at the date of acquisition. The Company amortizes intangible assets on a straight-line basis over their estimated useful lives, which range between one and ten years.

Management also reviews intangible assets for impairment on an annual basis or whenever events or changes in circumstances indicate that the Company may not recover the carrying amount. Management recognizes an impairment loss when the carrying amount exceeds the projected undiscounted future net cash flows expected from its use and disposal. Management measures the loss as the amount by which the carrying amount exceeds its fair value, which is determined using discounted cash flows when quoted market prices are not available. The process of determining fair values is subjective and requires management to exercise judgement in making assumptions about future results, including revenue and cash flow projections and discount rates.

Goodwill

The Company is required to evaluate goodwill annually or whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recovered. Impairment is tested at the reporting unit level by comparing the reporting unit's carrying amount to its fair value. The Company estimates the fair value of the reporting unit using an income approach. To the extent a reporting unit's carrying amount exceeds its fair value; there is an impairment of goodwill. The Company measures impairment by comparing the fair value of goodwill, determined in a manner similar to a purchase price allocation, to its carrying amount. The process of determining fair values is subjective and requires management to exercise judgement in making assumptions about future results, including revenue and cash flow projections at the reporting unit level and discount rates.

Convertible loans and debentures

Upon issuance, convertible debentures and loans are classified into their equity and liability components based on their relative fair values. The liability components on convertible debentures and loans are accreted up to their principal value by way of a charge to earnings over the term of the debt, using the effective interest rate method.

Asset retirement obligations

Future obligations to retire an asset including dismantling, remediation and ongoing treatment and monitoring of the site are initially recognized and recorded as a liability at fair value, based on the Company’s current credit-adjusted, risk-free discount rate and an estimated inflation factor. The liability is adjusted for changes in the expected amounts and timing of cash flows required to discharge the liability and accreted to full value over time through periodic charges to earnings. The amount of the asset retirement liability initially recognized is capitalized as part of the asset’s carrying value and amortized over the asset’s estimated useful life. Future asset retirement obligations are only recorded when the timing or amount of remediation costs can be reasonably estimated.

Leases

Leases are classified as capital or operating leases. A lease that transfers substantially all the benefits and risks incident to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases whereby lease payments are expensed. Gains and losses arising on sale and leaseback transactions, when the leaseback is classified as a capital lease, are deferred and amortized in proportion to the amortization of the leased asset. Lease inducements received are recorded as a deferred credit and amortized as a reduction of lease expense over the term of the lease.

3 Accounting

New accounting policies

Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants (CICA) standards 1535, 3031, 3862 and 3863.

- Section 1535 – Capital Disclosures: This section requires the Company to disclose its objectives, policies and processes for managing capital (note 4).
- Section 3031 – Inventories: This section prescribes the accounting treatment for inventories and provides guidance on the determination of cost and subsequent recognition as an expense, including any write-down to net realizable value. Adoption of this standard did not have any significant impact on the Company’s reported results.
- Section 3862 – Financial Instruments Disclosures: This section enhances the disclosure requirements on the nature and extent of risks arising from financial instruments and how the Company manages those risks (note 5).
- Section 3863 – Financial Instruments Presentation: This section provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instrument related presentation disclosures.

Recent accounting pronouncements

Effective January 1, 2009, the Company will adopt CICA standard 3064. The Company does not expect this standard to have a significant effect on its financial statements.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred.

4 Capital Risk Management

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern and to provide an adequate return to shareholders, while satisfying other stakeholders.

The Company includes long-term debt, preferred shares and capital stock in its definition of capital, as shown in the Company's balance sheet.

The Company's primary objective in its management of capital is to ensure that it has sufficient financial resources to fund ongoing operations and new program investment. In order to secure this capital the Company may attempt to raise funds via issuance of debt and equity, or by securing strategic partners. The financial covenants by which the Company's debt agreements are bound are working capital, debt to tangible net worth, and debt service coverage ratios.

5 Financial Risk Management

The Company is exposed to certain financial risks, including currency risk, credit risk, liquidity risk and interest rate risk.

a) Currency Risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange loss recorded in 2008 was $2,349,000 as compared to a $1,321,000 gain for the year ended December 31, 2007. The Company used derivative financial instruments to mitigate its exposure to currency risks in 2008 and 2007.

As at the balance sheet date, the Company had the following US dollar denominated balances:

Accounts receivable	$ 6,585,000
Bank indebtedness	19,514,000
Accounts payable	4,835,000
Long-term debt	2,431,000

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in a (decrease) increase of approximately $2,020,000 in net earnings for the year ended December 31, 2008.

b) Foreign Exchange Forward Contracts

The Company uses derivative financial instruments to reduce it exposure to foreign currency risk associated with its revenues and costs of certain procured items.

Foreign exchange exposure to US dollar sales, purchases, and related receivables and payables is in part managed by the use of foreign-exchange-forward contracts. During 2008, the Company entered into USD$25,000,000 of foreign-exchange-forward contracts which will be executed during 2009, with the provider of its operating lines of credit. The Company has marked to market its unrealized foreign-exchange-forward contracts as at December 31, 2008 and recorded a gain of $538,000 in unrealized derivative gains during the year-ended December 31, 2008 (December 31, 2007: $171,000).

c) Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counter-party to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group (Boeing), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna).

As at the balance sheet date 75% of the Company's trade accounts receivable are attributable to these three customers.

d) 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 manages liquidity risk through the management of its capital structure and financial leverage as outlined in note 4 to the consolidated financial statements. Other matters related to liquidity risk are set out in note 1.

Accounts payable and accrued liabilities are all due within the next twelve months.

The Company's operating line of credit is due on demand. Long-term debt repayments are as outlined in note 14.

The Company uses derivative financial instruments to reduce its exposure to price risk associated with its revenues and costs of certain procured items.

Sales Contracts

A number of the Company's sales contracts have a price adjustment clause where the final sales price is determined by certain indices in a period prior to the date of sale. As a result, the final sales price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of sale. As at December 31, 2008, the Company has $23,098,000 (December 31, 2007: $66,026,000) of firmly committed orders that include price adjustment clauses of this nature. A $36,000 loss has been recorded in unrealized derivative gains for the year ended December 31, 2008 as compared to a $3,000 loss for the year ended December 31, 2007 as a result of the change in the fair value of the underlying embedded derivatives.

Purchase Contracts

A number of the Company's purchase contracts have a price adjustment clause where the final purchase price is determined by certain indices in a period prior to the date of purchase. As a result, the final purchase price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of purchase. As at December 31, 2008, the Company has $764,000 (December 31, 2007: $3,000) of firmly committed purchases that include price adjustment clauses of this nature. No gain or loss has been recorded in unrealized derivative income for the year ended December 31, 2008 as compared to a $2,000 gain for the year ended December 31, 2007 as a result of the change in the fair value of the underlying embedded derivatives.

Other Assets and Liabilities

Other assets are comprised of $38,000 inflation derivatives assets arising from the Company's sales and purchase contracts having price adjustment clauses within their terms, and $708,000 fair value derivatives assets arising from its foreign-exchange-forward contracts (December 31, 2007: $138,000).

e) Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 0.875%, 1.00%, 1.175% or 1.25% determined on a quarterly basis according to specified measures of the ratio of debt to tangible net worth (note 11). Borrowing in excess of $17,000,000 will be cash secured. The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the year ended December 31, 2008, with other variables unchanged, a 1% change in the bank prime interest rate would have a $143,000 impact on net earnings or cash.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The Company primarily finances the purchase of long-lived assets at fixed interest rates.

f) Financial Assets and Liabilities by Category

As at December 31, 2008 and 2007, the Company's financial assets and liabilities are categorized as follows:

December 31, 2008	Loans and receivables	Held at fair value	Financial assets and liabilities at amortized cost	Total
Financial Assets				
Accounts receivable	$ 12,609	$ -	$ -	$ 12,609
Warranty claim receivable	1,784	-	-	1,784
Currency and commodity contracts	-	746	-	746
Financial Liabilities				
Bank indebtedness	-	-	14,273	14,273
Accounts payable and accrued liabilities	-	-	15,841	15,841
Long-term debt	-	-	9,145	9,145

December 31, 2007	Loans and receivables	Held at fair value	Financial assets and liabilities at amortized cost	Total
Financial Assets				
Accounts receivable	$ 12,224	$ -	$ -	$ 12,224
Warranty claim receivable	1,454	-	-	1,454
Currency and commodity contracts	-	138	-	138
Investment	-	-	759	759
Financial Liabilities				
Bank indebtedness	-	-	11,279	11,279
Accounts payable and accrued liabilities	-	-	14,812	14,812
Long-term debt	-	-	8,817	8,817

g) Fair values

The fair values of the Company's accounts receivable are estimated to approximate their carrying values due to the immediate or short-term maturity of these financial instruments. The fair value of the Company's bank indebtedness, accounts payable and accrued liabilities and current portion of long-term debt are significantly lower than carrying value due to the Company's current financial condition. The fair value of the long-term debt is estimated using present value techniques and assumptions concerning the amount and timing of expected future cash flows and discount rates which reflect current market rates on similar financial instruments.

For the year ended December 31	**2008**		2007	
	Carrying value	**Fair value**	Carrying Value	Fair value
Long-term debt amounts due in greater than one year	**$ 2,872**	**$ 2,626**	$ 6,761	$ 6,302

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

6 Inventories

For the year ended December 31	2008	2007
Raw materials	**$ 5,768**	$ 6,454
Work in progress	**12,219**	10,546
Finished products	**1,219**	801
	19,206	17,801

7 Development Costs

Development costs represent hard and soft tooling, and prototype design costs incurred for various customer programs.

For the year ended December 31	2008	2007
Opening balance	**$ 1,545**	$ 1,186
Additions	**2,766**	744
Disposals	**-**	-
Amortization	**(1,012)**	(385)
	3,299	1,545

8 Property, Plant and Equipment

For the year ended December 31			2008			2007
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Computer hardware and software	**$ 8,396**	**$ 5,125**	**$ 3,271**	$ 7,431	$ 3,923	$ 3,508
Machinery and equipment	**37,209**	**21,634**	**15,575**	39,154	22,928	16,226
Leasehold improvements	**956**	**371**	**585**	864	288	576
	46,561	**27,130**	**19,431**	47,449	27,139	20,310

Included in computer hardware and software are assets held under capital leases at a cost of $1,377,000 (2007: $1,269,000) having accumulated depreciation of $633,000 (2007: $412,000).

Included in machinery and equipment are assets held under capital leases at a cost of $5,653,000 (2007: $3,112,000) having accumulated depreciation of $903,000 (2007: $149,000).

Also included in machinery and equipment is aircraft tooling which will be amortized to cost of sales, using the lesser of straight-line on a unit-of-production basis over the expected life of the program or the contract period for the program.

Included in leasehold improvements are assets held under capital leases at a cost of $52,000 (2007: $52,000) having accumulated depreciation of $7,000 (2007: $2,000).

9 Investment

The Company’s investment consisting of 5,264 Series D Preferred Stock of Eclipse Aviation Corporation.

On September 30, 2008, the Company determined that its investment was subject to an other than temporary impairment and wrote the carrying value of $759,000 down to an estimated fair value of $Nil.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

10 Intangible Assets and Goodwill

The fair value of intangible assets arising from the December 31, 2007 acquisition of Comtek amounted to $2,620,000.

	Estimated Useful Lives (years)	**December 31, 2008**			December 31, 2007		
		Cost	**Accumulated Amortization**	**Net**	Cost	Accumulated amortization	Net
Customer relationships	6	**$ 1,320**	**$ 189**	**$ 1,131**	$ 1,320	$ -	$ 1,320
Order backlog	-	**130**	**130**	**-**	130	-	130
Trade name	4	**300**	**60**	**240**	300	-	300
Patents	9	**870**	**87**	**783**	870	-	870
		2,620	**466**	**2,154**	2,620	-	2,620

The Company amortizes intangible assets on a straight-line basis over their estimated useful lives, which range between one and ten years.

Goodwill in the amount of $571,000 arose on December 31, 2007 as a result of the Company's acquisition of Comtek Advanced Structures Ltd. (December 31, 2008: $Nil).

In accordance with Canadian GAAP, the carrying value of goodwill is tested for impairment on an annual basis or when events or circumstances indicate that the related carrying amount may not be recoverable on a reporting unit basis. As of December 31, 2008, the Company performed its annual impairment test in evaluating goodwill for impairment, estimates of after-tax discounted future cash flows of the Comtek operations were used to estimate the fair value. The cashflow included management's projections of long-term selling prices, operating costs and margins, capital expenditures and cost of capital. There are inherent uncertainties related to these factors and management's judgement in applying them to the analysis of goodwill impairment.

Goodwill was assessed for impairment using a two-step approach. The first step compared the fair value of the reporting unit to its carrying value. The Company performed this test and determined that the fair value of its Comtek unit was less than its carrying values, which required the Company to perform the second step test. This step compared the fair value of Comtek's goodwill to its carrying amount. The Company determined that the fair value of goodwill of Comtek was less than the respective goodwill carrying amount, which required the Company to recognize an impairment charge of $571,000 reducing the carrying value of the goodwill to $Nil.

11 Bank Indebtedness

The Company has operating lines of credit with a Canadian chartered bank totalling $22,000,000 (2007: $17,000,000). The facilities are due on demand. Borrowing in excess of $17,000,000 will be cash secured.

Interest is at prime plus 0.875%, 1.00%, 1.175%, or 1.25% determined on a quarterly basis according to specific measures of the ratio of debt to tangible net worth. The US dollar sub-limit for the operating line of credit is USD$15,000,000. The operating line of credit has a foreign forward exchange facility having a notional risk for credit purposes of $3,528,000, to purchase foreign forward exchange contracts for major currencies, with a maximum maturity of 12 months.

As a condition of obtaining these operating lines of credit, security has been provided in the form of:

- general security agreement creating a first priority security interest in all present and after-acquired personal property of the Company and a floating charge over all of the Company's present and after-acquired real property;
- assignment/endorsements by the Company to the Bank of all risk insurance on all of the Company's real and personal property with the Bank as first loss payee; and

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

- guarantee of the indebtedness of the Company to the Bank, executed by a shareholder limited to $2,000,000; as consideration for the guarantee, the Company pays the shareholder a 10% fee on $2,000,000 calculated on a daily basis (note 24).

As at December 31, 2008, the Company was not in compliance with its working capital covenant. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009. The Company has not obtained a waiver from the debt holder for either the current breach at the balance sheet date or for anticipated future breaches. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment.

In 2009 the Company will be required to seek an amendment of its borrowing terms to either waive any breaches, or modify the covenants. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage.

12 Deferred Tooling Revenues

For the year ended December 31	2008	2007
Opening balance	**$ 2,676**	$ 3,434
Additions	**104**	465
Amortization	**(1,607)**	(1,223)
	1,173	2,676

The Company sold tooling on certain aircraft programs to customers. The customers are allowing the Company to use the tooling for production of aircraft components for the life of those programs. Accordingly, as the Company will receive the full benefit of the use of the tooling, the sale amount is deferred and will be amortized to income, straight-line on a units-of-production basis over the expected life of the program. The cost of the tooling has been re-classified from development costs to property, plant and equipment and will also be amortized to income, straight-line on a units-of-production basis.

13 Lease Inducement and Prepaid Rent

Concurrent with a sale and leaseback transaction recorded in 2003, the Company recorded a lease inducement credit of $1,500,000 and a related prepaid rent amount of $1,500,000.

The lease inducement credit is being amortized against rental expense over the term of the lease. It has an unamortized balance of $962,000 as at December 31, 2008 (December 31, 2007: $1,060,000). The related prepaid rent amount recorded of $1,500,000 is being charged to rental expense over the term of a rent-free period which arises in 2008 and 2009. Consequently, $1,126,000 (December 31, 2007: $Nil) of the rental prepayment has been amortized during 2008. The remaining $374,000 (December 31, 2007: $1,500,000) is classified within Prepayments on the balance sheet.

14 Long-Term Debt

For the year ended December 31	2008	2007
Convertible debenture due December 2009 (a)	**$ 4,097**	$ 4,497
Bank term loan (b)	**-**	331
Capital leases (c)	**4,096**	2,806
Accrued government royalties (d)	**952**	1,183
	9,145	8,817
Less: Current portion	**(6,273)**	(2,056)
	2,872	6,761

a) Convertible Debenture Due December 2009

The principal outstanding debenture amount of $4,097,000 is convertible at the option of the holder (Export Development Canada) into 293,713 shares at a conversion price of $13.95. The Company can require conversion of the full amount of the debenture in the event that the weighted average trading price of the Company's shares on the Toronto Stock Exchange is greater than 125% of the conversion price for 20 consecutive days.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The debenture bears interest at 7.0% per annum and is unsecured.

Principal repayments are payable in 14 quarterly installments of $100,000 commencing on December 31, 2006 with the final installment of $3,797,000 due and payable on December 31, 2009, accordingly the debenture is classified within current portion of long-term debt on the balance sheet.

As at December 31, 2008, the Company was not in compliance with its working capital and debt servicing covenants associated with the convertible debenture. The Company has not obtained a waiver from the debt holder for these non-compliances and for anticipated future breaches. On March 13, 2009, Export Development Canada served notice to the Company requiring that if the non-compliances are not rectified within 60 days of the notice date, all balances shall become payable on demand. In addition, the Company is forecasting that it will be in default of one or more of its covenants in 2009. In the absence of obtaining a waiver of such breach, it would entitle the lender to demand immediate payment.

In 2009, the Company will be required to seek an amendment of its borrowing terms to either waive any breaches, or modify the covenants. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage. The Company is currently negotiating the terms of repayment with Export Development Canada (note 27c).

b) Bank Term Loan

A Canadian chartered bank held a term loan with Comtek which was repaid in full during 2008.

c) Capital Leases

There are various equipment leases that have a weighted average interest rate of 6.74% per annum. The leases are secured by way of a charge against specific assets. The leases are repayable in equal installments over periods up to 60 months. $2,961,000 of the leases are held in US dollars.

d) Accrued Government Royalties

Royalties of $952,000 (December 31, 2007: $1,183,000) are payable to Technology Partnerships Canada. The balance is repayable by June 30, 2009.

15 Obligations and Commitments Under Capital and Operating Leases

The Company has committed to payments under certain capital and operating leases relating to manufacturing machinery and equipment, and building lease costs. Future minimum lease payments required in each of the next five fiscal years and thereafter are:

For the year ended December 31		**2008**		2007
	Operating	**Capital**	Operating	Capital
2008	**$ -**	**$ -**	$ 1,674	$ 911
2009	**2,527**	**1,223**	2,311	882
2010	**2,861**	**1,147**	2,620	617
2011	**2,774**	**987**	2,465	492
2012	**2,532**	**795**	2,167	346
2013	**2,556**	**94**	2,167	-
Thereafter	**12,284**	**-**	10,506	-
Total future minimum lease payments	**25,534**	**4,247**	23,910	3,248
Less: Imputed interest	**n/a**	**(150)**	n/a	(442)
Balance of obligation under capital leases included in long-term debt (note 14)	**n/a**	**4,096**	n/a	2,806

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

For the year ended December 31, 2008, an amount of $2,775,000 representing payments under operating leases was expensed (2007: $1,981,000).

16 Capital Stock

Authorized

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, issuable in series, the terms of which are determined by the directors at the time of creation of each series.

Common shares issued or reserved:

	Number of shares	Amount
December 31, 2006	27,836,627	$ 55,600
Share issue (c)		
Cash	1,069,398	1,680
Conversion from preferred shares	2,439,241	3,782
Acquisition of Comtek	99,458	129
Issuance costs	-	(67)
	3,608,097	5,524
Transfer from contributed surplus on exercise of options and warrants	-	70
December 31, 2007	31,444,724	61,194
Share issue (b)		
Cash	411,294	371
Conversion from Preferred Shares	28,571	50
Non-cash	430,340	387
	870,205	808
Transfer from contributed surplus on exercise of options and warrants	-	267
December 31, 2008	32,314,929	62,269

a) The Company has reserved a total of 293,713 common shares, the maximum number that may be exercised under the terms of the convertible debenture due December 2009 (note 14a).

b) During 2008, the Company issued 870,205 common shares from the following transactions:

i) Exercise of Warrants

Holders of warrants exercised a total of 675,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 244,660 common shares at a price of $0.90, for gross proceeds of $220,000. The remaining 430,340 common shares issued at a price of $0.90 amounting to $387,000 was used to pay amounts owing.

ii) Exercise of Options

Holders of options exercised a total of 166,634 share purchase options resulting in the issuance of 166,634 common shares at a price of $0.90 per share, for total gross proceeds of $150,000.

iii) Exercise of Preferred Shares

A holder of preferred shares converted 5,000 preferred shares resulting in the issuance of 28,571 common shares at $1.75 per share.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

c) During 2007, the Company issued 3,608,097 common shares from the following transactions:

i) Exercise of Warrants

Holders of warrants exercised 50,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 50,000 common shares at $0.90 per share for gross proceeds of $45,000.

ii) Exercise of Options

Holders of options exercised a total of 179,398 share purchase options resulting in the issuance of 167,398 shares at $1.08 per share and 12,000 shares at $1.40 per share for total gross proceeds of $198,000.

iii) Common Share Issue

During the year ended December 31, 2007, the Company entered into a placement of 840,000 units at $2.20 per unit; 287,500 units were subscribed for by insiders of the Company. Each unit consists of one share and one warrant, where one warrant entitles the holder the right to purchase one additional share at $2.40 per share for a 24-month period from the closing date. Proceeds of the unit offering were split between capital stock and warrants.

iv) Preferred Share Conversion

Holders of preferred shares converted 378,200 preferred shares resulting in the issuance of 2,439,241 common shares at $1.55 per share.

v) Common Share Issue on Acquisition of Comtek.

On December 31, 2007, the Company issued 99,458 common shares to shareholders of the acquired Company at a value of $1.30 per share.

The costs of issuing the capital stock during 2007 amounted to $67,000 and were deducted from total proceeds of $1,680,000 to record $1,613,000 as capital stock.

d) The Company's incentive stock option plan is administered by the Board of Directors. The maximum number of common shares that may be optioned is 3,166,667. The period during which an option is exercisable shall not exceed 10 years. Existing stock options vest over periods ranging from immediately to two years.

A summary of the Company's stock option plan as of December 31, 2008 and December 31, 2007, and changes during the periods ending on those dates, is presented below.

For the year ended December 31		**2008**		2007
	Shares (000's)	**Weighted Average Exercise Price**	Shares (000's)	Weighted Average Exercise Price
Outstanding - Beginning of year	**940**	**$ 1.28**	1,059	$ 1.22
Granted	**-**	**-**	60	1.85
Forfeited	**(713)**	**1.33**	-	-
Exercised	**(167)**	**0.90**	(179)	1.10
Outstanding - End of year	**60**	**1.85**	940	1.28

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The following table summarizes stock options outstanding and exercisable:

Options outstanding and exercisable at December 31, 2008

	Number (000's)	Weighted average remaining contractual life (years)	Weighted average exercise price
$1.50 - $3.00	60	0.08	$ 1.85

e) The Company's contributed surplus is comprised as follows:

For the year ended December 31	**2008**	2007
Beginning of year	**$ 2,857**	$ 2,244
Stock-based compensation expense	**57**	199
Fair value of warrants	**-**	73
Allocation of units offering proceeds to warrants	**-**	411
Transfer to capital stock on exercise of options and warrants	**(267)**	(70)
End of year	**2,647**	2,857

17 Preferred Shares

On July 10, 2006, the Company issued 1,200,000 preferred shares at an issue price of $10.00 per preferred share. Gross proceeds from the 2006 issuance of preferred shares amounted to $12,000,000; $4,365,000 of the gross proceeds receivable was used to retire debt; the remaining $7,635,000 was received in cash. The costs of issuing the preferred shares during 2006 amounted to $546,000 and were deducted from total proceeds.

The preferred shares provide for a 9.25% per annum dividend, payable quarterly in cash on the last day of March, June, September and December with the first dividend payable on December 31, 2006. Dividends paid during the year ended December 31, 2008 amounted to $758,000 (December 31, 2007: $920,000).

Each preferred share will be convertible at any time, without the payment of additional consideration, at the option of the holder, on the following basis:

- Year 1 ended July 10, 2007: into 6.45 common shares, at a conversion price of $1.55 per common share;
- Year 2 ended July 10, 2008: into 5.71 common shares, at a conversion price of $1.75 per common share;
- Year 3 ended July 10, 2009: into 5.00 common shares, at a conversion price of $2.00 per common share;
- Year 4 ended July 10, 2010: into 4.26 common shares, at a conversion price of $2.35 per common share; and
- Thereafter: into 3.64 common shares, at a conversion price of $2.75 per common share.

The conversion price will be subject to adjustment in certain circumstances pursuant to customary anti-dilution provisions.

From July 1, 2008 to June 30, 2011, the preferred shares will be redeemable at the option of the Company at issue price plus accrued and unpaid dividends, provided that the volume weighted average trading price of the common shares on the Toronto Stock Exchange, for at least 20 trading days in any consecutive 30-day period ending on the fifth trading day prior to the date on which the notice of redemption is given, exceeds 125% of the conversion price. From July 1, 2011, the preferred shares will be redeemable at issue price plus accrued and unpaid dividends.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

At any time after June 30, 2011, the preferred shares will be redeemable in whole or in part at the option of the holder at the issue price plus all accrued and unpaid dividends thereon calculated to the date of redemption if:

- at any time after that date the current market price on the fifth day prior to such date is less than $2.75; or
- there is a change in control of the Company involving the acquisition of voting control or direction over 66-2/3% or more of the common shares.

Prior to December 31, 2008, holders of preferred shares converted 383,200 preferred shares resulting in 816,800 preferred shares remaining having a $7,622,000 book value.

18 Stock-Based Compensation

The Company records compensation expense for the fair value of the stock options granted under its incentive stock option plan using the Black-Scholes option-pricing model. This model determines the fair value of stock options granted and amortizes it to earnings over the vesting period.

No stock options were granted during the year ended December 31, 2008.

	2008	2007
Risk-free interest rate (%)	**-**	4.19
Dividend yield (%)	**-**	0
Expected lives (years)	**-**	1.75
Volatility (%)	**-**	54.41

The fair value of options expense, for options granted in current and prior periods, amortized to earnings during the year ended December 31, 2008 was $57,000 (December 31, 2007: $199,000).

The Black-Scholes option-pricing model used by the Company to calculate option values was developed to estimate the fair value of freely tradeable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable, single measure of the fair value of options granted by the Company.

19 Defined Contribution Plan

The total cost recognized and paid for the Company's defined contribution plan is as follows.

For the year ended December 31	**2008**	2007
Defined contribution plan	**$ 1,438**	$ 1,283

The Company's contribution to the plan is calculated on a percentage of employee wages. The range of percentages is 1.5% to 8.5%. The plan is available to all employees.

20 Interest Expense and Financing Charges

For the year ended December 31	**2008**	2007
Interest on capital leases	**$ 263**	$ 134
Interest on other long-term debt	**303**	332
Interest on short-term debt	**1,913**	1,628
Net interest expense	**2,479**	2,094

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

21 Supplementary Cash Flow Information

a) Items not affecting cash:

For the year ended December 31	2008	2007
Accrued government royalties	$ 1,290	$ 1,046
Amortization and depreciation	4,599	3,395
Deferred tooling revenue amortization	(1,710)	(913)
Development cost amortization	1,012	385
Expenses settled by issue of common shares	387	-
Prepaid rent amortization	1,126	-
Provision for loss-making contracts	(497)	1,039
Provision for obsolete inventory	239	-
Stock-based compensation	57	199
Unrealized derivative gains	(608)	(98)
Write-down of goodwill	571	-
Write-down of investment	759	-
Other items	438	(263)
	7,663	4,790

b) Changes in non-cash items:

For the year ended December 31	2008	2007
Accounts receivable	$ (384)	$ (2,565)
Inventories	(1,147)	2,396
Prepayments	(5)	389
Warranty claim receivable	(164)	-
Accounts payable and accrued liabilities	1,010	(1,543)
Warranty provision	101	-
	(589)	(1,323)

c) Non-cash financing and investing activities:

For the year ended December 31	2008	2007
Assets acquired under capital leases	$ 483	$ 903
Conversion of preferred shares	50	3,782
Shares and warrants issued for investment in Comtek Advanced Structures Ltd.	-	202

22 Contingencies

a) The Company has agreements with Technology Partnerships Canada (TPC), under which TPC will make cash contributions to the Company's various projects, up to a cumulative maximum of $8,912,000. In return, a royalty will be paid to TPC by the Company based on the selling price and units sold. During the year ended December 31, 2008, the Company received $131,000 (2007: $226,000) from TPC. This amount was credited to development costs, as it related directly to certain long-term programs, and as a recovery of expenses.

b) The Company's subsidiary, Comtek Advanced Structures Ltd. has an agreement with TPC, under which TPC has made cash contributions to Comtek Advanced Structures Ltd.'s various projects, in the amount of $3,325,000. In return, a $350,000 royalty will be paid to TPC by Comtek Advanced Structures Ltd. on each of June 30, 2008 and June 30, 2009, after which payment, no further amount will be due.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

c) During 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $1,454,000 discounted charge within cost of sales in 2007. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $1,454,000 recovery was accrued within cost of sales. During 2008, the Company revised its discounted warranty provision to $1,521,000 and discounted warranty recovery to $1,569,000. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur over a four to five year period.

d) During 2008, the Company became aware of the requirement to rework product, some of which had been delivered to a customer. A portion of the rework was performed in 2008, with the remaining rework to be completed in 2009. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $215,000 charge within cost of sales in 2008. An equivalent claim against the manufacturer of a sub-component of the product was also made. Accordingly, a $215,000 recovery was accrued within cost of sales. The claim has been settled with the supplier subsequent to year end for the full amount claimed.

23 Income Taxes

a) A reconciliation of income taxes at statutory rates to actual income taxes is as follows:

For the year ended December 31	**2008**	2007
Combined basic income tax rate	31.0%	34.1%
Income tax (recovery) at the basic income tax rate	$ (698)	$ (586)
Other	329	186
Impact of change in statutory income tax rate	987	1,746
Change in valuation allowance	(618)	(2,516)
Expiry of ITC	-	1,170
	-	-

b) The tax effect of temporary differences that give rise to significant portions of future tax assets and future tax liabilities as at December 31 are as follows:

For the year ended December 31	**2008**	2007
Future income tax assets (liability)		
Non-capital losses	$ 5,383	$ 6,049
Scientific research expenditures	2,318	2,407
Investment	199	104
Capital losses	648	673
Property, plant and equipment	5,053	5,550
Gain deferred for accounting purposes	566	621
Expenses not deductible in current period	1,279	582
Financing costs	292	388
Investment tax credits	791	773
Intangible asset	(761)	(761)
	15,768	16,386
Less: Valuation allowance	(16,954)	(17,572)
Net future income tax asset (liability)	(1,186)	(1,186)

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

c) The Company has available non-capital loss carry-forwards totalling approximately $20,361,000. These losses expire as follows:

Expiry Date	Loss Carry-Forwards
2010	$ 3,301
2014	5,451
2015	8,416
2026	412
2027	2,781

d) The Company has approximately $8,915,000 of unclaimed research and development costs that may be claimed against future taxable income.

e) The Company has accumulated net capital losses for tax purposes of approximately $2,491,000 which may be carried forward and used to reduce taxable capital gains in future years.

f) The Company has investment tax credits (ITC's) from Scientific Research and Experimental Development expenditures, which can be applied to reduce income taxes payable in future years. The ITC's expire as follows:

Expiry Date	ITC
2018	$ 705
2021	364

No net future tax benefit has been recognized in these financial statements with respect to these losses.

24 Related Party Transactions

During the year ended December 31, 2005, the Company entered into an agreement with a certain shareholder and director in consideration of mutual agreements with a Canadian chartered bank under which the shareholder and director guarantees the indebtedness of the Company to the Bank limited to $2,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a fee ranging from 5% to 10% on the $2,000,000 limited guarantee calculated on a daily basis. Fees paid to a certain shareholder and director during the year ended December 31, 2008 amounted to $100,000 (December 31, 2007: $58,000). Fees payable to a certain shareholder and director as at December 31, 2008 are $100,000 (December 31, 2007: $75,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $125,000 for the year ended December 31, 2008 (December 31, 2007: $100,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders and directors on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to a certain shareholder and director during the year ended December 31, 2008 amounted to $240,000 (December 31, 2007: $60,000). Fees payable to a certain shareholders and directors as at December 31, 2008 are $120,000 (December 31, 2007: $180,000). These fees are included in the Statements of Operations as cost of sales and amount to $180,000 for the year ended December 31, 2008 (December 31, 2007: $240,000).

During the year ended December 31, 2008, consulting services were provided by certain directors. Fees paid to certain directors during the year ended December 31, 2008 amounted to $84,000 (December 31, 2007: $10,000). Fees payable to certain directors as at December 31, 2008 are $Nil (December 31, 2007: $47,000). These fees are included in the Statements of Operations as administrative and general expenses and amount to $37,000 for the year ended December 31, 2008 (December 31, 2007: $57,000).

Other related-party transactions are disclosed elsewhere in these financial statements (note 16b and 27b).

These transactions were conducted in the normal course of business and were accounted for at the exchange amount.

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

25 Economic Dependence and Segmented Information

a) Sales to three major customers, which comprise several programs and contracts, accounted for approximately 86.9% (December 31, 2007: 91.6%) of sales.

For the year ended December 31	**2008**		2007	
	Revenue	**% of Total**	Revenue	% of Total
Boeing	**$ 18,518**	**14.4**	$ 19,327	17.5
Bombardier	**28,760**	**22.3**	24,025	21.8
Cessna	**64,710**	**50.2**	57,666	52.3
Other	**16,880**	**13.1**	9,265	8.4
Total	**128,868**	**100.0**	110,283	100.0

b) The Company operates in one industry that involves the manufacture and sale of aerospace products. The Company has two operating segments. All of the Company's operations and assets are in Canada.

26 Business Acquisition

On April 2, 2007, the Company entered into a preliminary agreement to acquire all of the shares of a composite aerostructures manufacturing business. The acquisition closed on December 31, 2007.

Prior to the closing date of December 31, 2007, the Company advanced Comtek Advanced Structures Ltd. $1,850,000 under the terms of a convertible loan agreement, which was subsequently applied as cash consideration in the purchase price.

In addition to the $1,850,000 invested into Comtek Advanced Structures Ltd., the Company assumed and repaid $150,000 of shareholder loans on behalf of Comtek Advanced Structures Ltd., and made payments totalling $73,000 to a group of its shareholders.

A majority of the principals of Comtek Advanced Structures Ltd. will remain and have agreed to assign their shares to the Company for 450,000 Company warrants, exercisable over a three-year period from closing, at an exercise price of $2.60 in year 1, $3.00 in year 2, and $3.50 in year 3. Comtek Advanced Structures Ltd. minority shareholders received 37,880 Company warrants, exercisable over an 18-month period from closing, at an exercise price of $2.50. The fair value of the 487,880 warrants issued to Comtek Advanced Structures Ltd. shareholders is $73,000. The Black-Scholes warrant-pricing model used by the Company to calculate warrant values utilizes subjective input assumptions whose change can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable, simple measure of the fair value of warrants issued by the Company.

The Company also issued 99,458 common shares to the shareholders of Comtek Advanced Structures Ltd. The $129,000 fair value of these common shares was estimated at the Company's December 31, 2007 market closing price of $1.30 per common share.

In addition, the Company has agreed to pay to the principal shareholders of Comtek Advanced Structures Ltd. one-third of the composite business' EBITDA for the year ending December 31, 2010, which is payable two-thirds in cash and one-third in the Company shares at the then current market price.

The costs of completing this acquisition amounted to $102,000.

The transaction was completed on December 31, 2007 and was been negotiated at arm's length.

The acquisition was accounted for as a business combination, using the purchase method. The purchase consideration provided was allocated to the fair values of the assets acquired and liabilities assumed as follows:

(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

For the year ended December 31	2007
Current assets	$ 3,343
Property, plant and equipment	2,052
Customer relationships	1,320
Order backlog	130
Trade name	300
Patents	870
Goodwill	571
	8,586
Bank indebtedness assumed	(925)
Current liabilities assumed	(3,315)
Liabilities assumed	(783)
Future income tax liability	(1,186)
Net assets assumed	2,377
Purchase consideration:	
Cash	2,073
Acquisition costs (included in accounts payable and accrued liabilities)	102
Company shares	129
Company warrants	73
	2,377

27 Subsequent Events

a) Subsequent to December 31, 2008, the Company incurred $548,000 severance expense related to reduction in staffing and workforce in anticipation of reduced aerostructures components requirements from its major customers.

b) During the first quarter 2009, a certain shareholder and director advanced the Company $400,000 at 12% interest per annum, for the purpose of funding severance payments made subsequent to year end. The principal and accrued interest are to be repaid in 2009.

c) On March 13, 2009, Export Development Canada provided a Notice Letter to the Company serving notice that should the breaches of covenants (note 14a) not be remedied by the date 60 days after the date of the Notice Letter, all principal of and interest on the debenture then outstanding shall be immediately due and payable by the Company to Export Development Canada. The Company continues to renegotiate in good faith the continued repayments of principal and interest with the Crown Corporation, with the objective of extending the repayment period beyond December 31, 2009.

AVCORP INDUSTRIES INC.

Board of Directors and Officers

Michael C. Scholz (2)(3)
CHAIRMAN OF THE BOARD
West Vancouver, British Columbia

Earnest Beaudin (1*)
DIRECTOR
Chief Executive Officer & General Counsel
Decker Management Ltd.
Calgary, Alberta

Eric Kohn *TD* (1)(2*)
DIRECTOR
Managing Partner
Barons Financial Services SA
Geneva, Switzerland

Kees de Koning (3)
DIRECTOR
Nootdorp, The Netherlands

(1) Member of the Audit and Corporate Governance Committee
(2) Member of the Compensation and Nominating Committee
(3) Member of the Executive Committee

* Designates the Committee Chair

Elizabeth Otis (3*)
DIRECTOR
Vashon, Washington

David Levi (1)(2)
DIRECTOR
President and CEO
GrowthWorks Capital Ltd.
Vancouver, British Columbia

Mark van Rooij (3)
DIRECTOR
Chief Executive Officer
White Rock, British Columbia

Paul Kalil
President
Vancouver, British Columbia

Edward M. Merlo
CORPORATE SECRETARY
Vice President, Finance
Richmond, British Columbia

Paul Meringer
Vice President, New Ventures
Surrey, British Columbia

Amandeep Kaler
Vice President, Operations
Surrey, British Columbia

Ken McQueen
Vice President, Organization Development
New Westminster, British Columbia

DIRECTORY

Bank

HSBC Bank Canada
Vancouver, British Columbia

Legal Counsel

Lang Michener LLP
Barristers & Solicitors
Vancouver, British Columbia

Registrar and Transfer Agent

CIBC Mellon Trust Company
Vancouver, British Columbia

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Annual General Meeting

Thursday, May 21, 2009 at 2:00 pm
at Avcorp Industries Inc.
10025 River Way, Delta, British Columbia

Avcorp Industries Inc.

10025 River Way
Delta, British Columbia
Canada V4G 1M7

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