AVCORP

annual report 2010

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, 562 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 31, 2011, and should be read in conjunction with the Company's financial statements and notes thereto for year ended December 31, 2010.

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 located in Ontario dedicated to composites, Comtek Advanced Structures Ltd. a wholly owned subsidiary and the other located in British Columbia dedicated to light weight metal manufacturing, Avcorp Industries Inc.

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, 2010.

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	2010	2009	2008
OPERATIONS			
Revenues	$ 77,258	$ 69,202	$ 128,868
EBITDA[1]	(2,241)	(2,500)	6,410
Operating income (loss) before tax	(5,277)	(5,501)	485
Net income (loss)	(7,606)	(8,410)	(2,251)
Basic income (loss) per share	(0.04)	(0.12)	(0.07)
Diluted income (loss) per share	(0.04)	(0.12)	(0.07)
FINANCIAL POSITION			
Net capital expenditures	1,228	402	2,771
Total assets	45,680	48,026	60,990
Bank indebtedness and long-term debt	16,853	16,364	23,418
Shareholders' equity	9,923	16,844	16,325
Book value per share	0.05	0.09	0.51
Ratio: debt/equity	1.70	0.97	1.43
Ratio: current assets/current liabilities	1.05	1.04	0.94
Shares outstanding at period end	195,505,323	177,732,112	32,314,929

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

Quarterly Results

The following table provides selected unaudited quarterly financial information for the eight most recent fiscal quarters to December 31, 2010.

QUARTERLY RESULTS

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

	2010				2009			
For the three months ended	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	$ 19,364	$ 21,808	$ 18,710	$ 17,376	$ 16,641	$ 14,302	$ 16,172	$ 22,087
Income (loss) from operations	(1,290)	77	(1,991)	(2,073)	(1,936)	(2,128)	552	(1,989)
EBITDA[1,2]	(1,329)	1,129	(957)	(1,084)	(1,377)	(1,103)	1,530	(1,550)
Net income (loss)	(2,710)	(269)	(2,297)	(2,330)	(2,718)	(2,585)	65	(3,172)
EBITDA per share[1,2]								
Basic	(0.01)	0.01	(0.00)	(0.01)	(0.01)	(0.02)	0.05	(0.05)
Diluted	(0.01)	0.01	(0.00)	(0.01)	(0.01)	(0.02)	0.05	(0.05)
Net income (loss) per share								
Basic	(0.01)	(0.00)	(0.01)	(0.01)	(0.02)	(0.06)	0.00	(0.10)
Diluted	(0.01)	(0.00)	(0.01)	(0.01)	(0.02)	(0.06)	0.00	(0.10)
Long-term debt	3,275[3]	3,866[3]	4,046[3]	2,380[3]	1,811[3]	2,034[3]	2,387[3]	2,843[3]

1. EBITDA = earnings before interest, taxes, depreciation and amortization
2. EBITDA is not a recognized term under GAAP
3. Exclusive of convertible debenture held by Export Development Canada classified as current portion of long-term debt

2010 and 2009 Results Overview

During the year ended December 31, 2010, the Company recorded a loss from operations of $5,277,000 on $77,258,000 revenue, as compared to a $5,501,000 loss from operations on $69,202,000 revenue for the preceding year; and a net loss for the current year of $7,606,000 as compared to a net loss of $8,410,000 for the year ended December 31, 2009.

The Company has realized revenue growth in 2010 from full rate production of the Boeing Defense Space & Security CH47 helicopter and the Cessna Citation CJ4 business jet; both programs were in start-up phase for the Company in 2009. Additionally, the Company has experienced an increase in revenue growth during 2010 relative to 2009 arising from deliveries of Bombardier CL605 and CL850 aircraft components; while customer demand for non-original equipment manufacturer's products and services has fallen.

As at December 31, 2010, the Company recorded a one-time non-cash charge against income in the amount of $1,482,000 for the full write-down of the carrying amount of intangible assets which arose on the 2007 acquisition of its subsidiary Comtek Advanced Structures Ltd. This write-down is as a result of management assessment of the recoverability of recorded amounts. Concurrently, the associated future income tax liability amounting to $858,000 has been recovered in its entirety.

It should be noted that the current year loss includes a $43,000 foreign exchange loss, while the loss for the year ended December 31, 2009 was mitigated by a $4,412,000 foreign exchange gain which occurred as a result of holding foreign-currency-denominated receivables, payables and debt.

Although customer demand for the Company's products has increased from the previous year, there remains within its operations significant levels of unutilized plant capacity. The Company has expensed $4,125,000 of overhead costs during the current year (December 31, 2009: $4,667,000) in respect of unutilized plant capacity.

The Company has decreased its provision for loss making contracts by $202,000 during the current year, due to improvements in some program gross margins as well as reductions in the anticipated number of aircraft components to be delivered.

During 2010 the Company provisioned for $428,000 of expected warranty expenditures relating to a manufacturing deficiency and a $417,000 provision for warranty expenditures due to a separate manufacturing deficiency arising within its supply chain with a sub-contractor.

During the year, the Company filed a motion to introduce proceedings in the Superior Court of Quebec for compensation as a result of the termination of a procurement contract. The Company is seeking compensation in excess of $18,000,000 for unrecovered costs incurred in accordance with the termination for convenience provisions of a contract terminated by the customer in 2007. As at the date of this report, no statement of defence has been filed and no court date has been set. During the year ended December 31, 2010 the Company incurred $657,000 of legal and consulting fees in the course of negotiating, analyzing and documenting the termination compensation.

Cash flows from operating activities during the current year utilized $2,694,000 of cash, as compared to utilizing $1,493,000 of cash during the year ended December 31, 2009. The Company has a working capital surplus of $1,316,000 as at December 31, 2010 (December 31, 2009: $820,000 surplus) and an accumulated deficit of $73,741,000 at December 31, 2010 (December 31, 2009: $65,379,000).

The Company has operating lines of credit with a Canadian chartered bank totalling $15,000,000 (December 31, 2009: $15,000,000). The facilities are due on demand. It should be noted that the credit available to the Company under its operating line of credit is equal to the amount determined by margin formula less $1,000,000.

On July 27, 2010, the Company entered into an Amending Agreement to the Forbearance Agreement with the bank providing its operating lines of credit. The Forbearance Agreement ended on October 15, 2010. The Company is subject to a quarterly review within which the Bank determines if there has occurred an event of default under the Forbearance Agreement. The Company is currently in the process of negotiating a renewal of the Forbearance Agreement with the bank.

On March 1, 2010, the Company completed a private placement of 17,773,211 common shares at $0.055 per share for gross proceeds of approximately $977,000. Subscribers in the private placement were Panta Holdings B.V. (Panta), which subscribed for 15,995,890 common shares, and Working Opportunity Fund (EVCC) Ltd. (WOF), which subscribed for 1,777,321 common shares. Both Panta and WOF are related parties to the Company.

On April 16, 2010, the Company issued a secured subordinated convertible loan, the $1,771,000 principal amount of which is currently convertible into a maximum of 29,516,666 common shares. Funding of the principal amount occurred on April 21, 2010.

The secured subordinated convertible loan was provided by Panta Holdings B.V. through a wholly-owned subsidiary. The loan, which is evidenced by a promissory note, has a five year term with an interest rate of 6% per year. The $1,771,000 principal amount is convertible into common shares at a conversion price of $0.06 per common share in the first two years of the loan, $0.07 per common share in the third and fourth years of the loan, and $0.08 per common share in the fifth year of the loan. Accumulated interest will not be convertible.

Assuming full conversion of the loan into the maximum 29,516,666 common shares, Panta will hold 117,830,842 common shares, representing approximately 52.4% of Avcorp's outstanding shares.

The proceeds from the convertible loan were used for working capital purposes, and to fund tooling and equipment.

The Company is currently working on obtaining additional debt and equity to provide working capital financing for anticipated revenue growth in 2011 and 2012.

A number of financing activities have taken place and are being pursued as of the date of this report. It is important to note that the success of these activities cannot be assured.

Going Concern

As at December 31, 2010, the Company was not in compliance with financial covenants 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 the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment.

Also, as at December 31, 2010, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada. The Company has obtained a waiver from the debenture holder for this non-compliance. However, the Company expects future breaches which would result in the lender being entitled to demand payment. Principal and interest on this loan are due March 31, 2011.

The Company has deferred and therefore not paid $1,512,000 of preferred share dividends which were accrued and payable as at December 31, 2010 (December 31, 2009: $756,000). On July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, will be redeemable at the option of the holder in whole.

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 in the next 12 months to exceed the current availability of the operating line of credit. During 2010, the Company completed a private placement and secured subordinated convertible loan, and will continue its efforts to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, secure additional revenue generating contracts, and reduce operating expenses 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.

Revenue

Revenue for the year ended December 31, 2010 was $77,258,000 as compared to $69,202,000 for the year ended December 31, 2009. On an annualized basis current year revenues have increased by 12% relative to the year ended December 31, 2009, primarily as a result of full rate production on new programs and a re-start of programs which were at times dormant in 2009.

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	2010		2009	
	Revenue	% of Total	Revenue	% of Total
Boeing	$ 23,629	30.6	$ 23,493	33.9
Bombardier	19,997	25.9	17,681	25.6
Cessna	24,763	32.1	15,419	22.3
Other	8,869	11.4	12,609	18.2
Total	77,258	100.0	69,202	100.0

Shipments of large assemblies to Boeing Commercial Airplane Group (Boeing CA), specifically for the 737 commercial jet program increased by 5% during 2010 relative to 2009. However, the positive impact of increased 737 commercial jet program deliveries was offset by revenues arising from US dollar sales converted at an exchange rate which was less favourable in 2010 than in 2009. The primary source of revenue from Boeing CA is from the 737 program. During 2009 the Company commenced delivering components to Boeing Defense, Space & Security (Boeing DSS) for the Chinook CH47 helicopter. The Company continues to work towards obtaining additional new contracts supporting Boeing commercial jet programs as well as Boeing DSS defense programs.

Revenues from Bombardier Aerospace (Bombardier) programs increased by 13% during the current year relative to last year for both the Challenger CL605 and the CL850 business jet programs. The Company's primary source of revenues from Bombardier in 2011 will continue to be from components on the CL605 and CL850 business jets, and composite floor boards for the CRJ and Q400 aircraft programs.

Deliveries of major structures to Cessna increased by 84% during 2010, relative to 2009. The increase in deliveries over 2009 was primarily due to full rate production of the Citation CJ4 business jet in 2010 whose first deliveries were in July 2009, and return to full production rates of structures for the Citation Sovereign business jet. As with Boeing US dollar denominated sales, the strengthening of the Canadian dollar in 2010 relative to 2009 has had an adverse impact on the revenues generated from Cessna business jet program deliveries. The primary sources of revenue from Cessna are from deliveries of components for the Citation Sovereign business jet, the Citation CJ3 business jet and the Citation CJ4 business jet. A continuation of deliveries for components of these aircraft is expected to comprise the majority of revenues from Cessna for 2011. The Company and Cessna have announced that the current production work will be transitioned back to Cessna. The Company will continue to fulfill orders until transition. Cessna has currently placed orders for the entire 2011 year. Discussions have not yet produced a definitive agreement with respect to the timing for the transition and associated compensation in connection with the transition.

Deliveries of Boeing 757 commercial jets wing adapter plugs for winglet retrofit to Aviation Partners Boeing have decreased relative to the year ended December 31, 2009. This is as a result of a reduced demand for these aircraft retrofits by airlines.

Revenues for Comtek Advanced Structures Ltd. (Comtek) fell by 20% in 2010 relative to 2009 as revenues in all market segments continued to be depressed due to decreased customer demand.

Foreign exchange has adversely impacted consolidated revenues by 6% during the current year relative to last year, as a result of the strengthening of the Canadian dollar relative to the US dollar.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2010 was 12.1% of revenue as compared to 6.7% of revenue for the year ended December 31, 2009. During 2010 gross margin has improved by $4,722,000 over 2009.

Gross profit has increased significantly during 2010 relative to the preceding year because increased revenues, resulting from resurgent customer demand as well as new program revenues, has had a positive impact on the Company's cost structure.

Overhead costs incurred in support of operational capabilities, as well as quality and engineering systems expenditures, have become less significant relative to revenues as customer program deliveries increased in 2010. Costs expensed as a result of idle plant capacity amounted to $4,125,000 during the year (December 31, 2009: $4,667,000). The cost-revenue imbalance was partially mitigated in 2010 by new program revenue growth, which is occurring with full rate production for the Citation CJ4 business jet components and full year delivery of components to Boeing Defense, Space & Security for the CH47 helicopter as well as increased customer demand for legacy programs.

The Company has decreased its provision for loss making contracts by $202,000 during the current year due to production efficiency improvements as well as a reduction in the anticipated number of aircraft components to be delivered.

New program revenue growth will be the largest factor in reducing the Company's cost structure and contributing towards offsetting idle capacity costs.

Administration and General Expenses

As a percentage of revenue, administration and general expenses decreased from 15.1% for the year ended December 31, 2009 to 14.0% for 2010, primarily as a result of increased revenues in 2010 relative to 2009. In absolute terms, the administrative and general expenses increased by $365,000 for the year ended December 31, 2010 relative to last year. The Company incurred legal and consulting fees in the course of negotiating, analyzing and documenting a termination claim it is pursuing with a customer. These are one-time costs for which fees amounting to $657,000 were expensed during 2010.

Foreign Exchange Gain or Loss

The Company recorded a $43,000 foreign exchange loss during 2010 (December 31, 2009: $4,412,000 gain) as a result of holding US dollar 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 $7,000 gain arose during the year ended December 31, 2010, as a result of holding purchase and sales contracts having embedded derivatives (December 31, 2009: $4,000 gain); while a $2,000 loss occurred during 2010 (December 31, 2009: $1,000 loss) as a result of derivative financial instruments associated with its procurement contracts. During 2008, the Company entered into USD25,000,000 of foreign-exchange-forward contracts which were executed during 2009, with the provider of its operating lines of credit. No such instruments were in place as at December 31, 2010 and 2009. The Company has not recorded a derivative gain or loss arising from foreign-exchange-forward contracts during the year-ended December 31, 2010 (December 31, 2009: $708,000 loss).

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) was negative $2,241,000 for the year ended December 31, 2010 compared to a negative EBITDA of $2,500,000 for the year ended December 31, 2009. It should be noted that the 2010 negative EBITDA included a one-time non-cash charge against earnings in the amount of $1,482,000 for the write-down of intangible assets and an associated $858,000 recovery of a future income tax liability; whereas the 2009 EBITDA included a $4,412,000 foreign exchange gain.

EBITDA

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

For the year ended December 31	2010	2009
Income (loss) for the period	$ (7,606)	$ (8,410)
Interest expense and financing charges	1,361	1,739
Income tax expense	-	-
Depreciation	3,425	3,747
Amortization of development costs and intangible assets	579	424
	(2,241)	(2,500)

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, 2010 was $1,307,000 as compared to $1,739,000 for the previous year. The reduction in interest and financing charges for 2010 is primarily as a result of having a lower operating line of credit utilization than in 2009. Interest and financing charges include $54,000 accretion of the equity component of a convertible loan (December 31, 2009: $Nil).

Write-Down of Assets No Longer in Use

Write-off of obsolete assets resulted in a $349,000 charge against income in 2010 (December 31, 2009:$793,000).

Write-Down of Intangible Assets

Revenues generated by the Company's subsidiary Comtek Advanced Structures Ltd. declined during 2010 indicating that the carrying amount of its intangible assets may not be recoverable. Consequently an impairment test of those assets was conducted whereby the subsidiary's expected future cash flows were assessed.

Based on the declining historic cash flows of the reporting unit, and estimated future cash flows from actual and expected revenues it was estimated that cash flows would be insufficient to recover the carrying value of the intangible assets. A full write-down of the $1,482,000 carrying amount of the intangible assets has been recorded as at December 31, 2010.

Income Taxes

The Company has not incurred a tax expense during the current year (December 31, 2009: $Nil).

Income or Loss

Loss for the year ended December 31, 2010 was $7,606,000 as compared to the $8,410,000 loss for the year ended December 31, 2009. The 2009 loss was mitigated by a $4,412,000 foreign exchange gain, while 2010 incurred a $43,000 foreign exchange loss as well as a one-time non-cash $1,482,000 charge against income for the write-down of intangible assets and an associated $858,000 recovery of a future income tax liability. Significantly improved gross profits in 2010 arising from increased revenues and improved operating efficiencies were offset by the adverse impact of a $4,125,000 charge against income for idle capacity, and $657,000 in legal and consulting fees.

Liquidity and Capital Resources

The Company ended the current year with bank operating line utilization of $8,158,000 compared to $8,422,000 as at December 31, 2009. Unless secured by cash, the Company's operating lines of credit provide for a total utilization of $15,000,000. On closing of the October 7, 2009 rights offering the operating line of credit guarantee provided by the former Chairman of the Board and shareholder was reduced by $1,000,000 thereby having the effect of reducing the Company's operating line of credit to $14,000,000 subject to asset margining stipulations.

The Company is forecasting its financing requirements for 2011 to exceed the current availability of the operating line of credit based on current asset margining stipulations. Accordingly, the Company has completed a private placement during the first quarter, and during the second quarter closed a secured subordinated convertible loan in the amount of $1,771,000. The Company expects to finance investment in the start-up of new military defence programs with milestone payments from customers. However, further debt and equity financing may be required.

Cash Flows from Operating Activities

Cash utilized by operating activities, before consideration of changes in non-cash items relating to operating activities, was $3,351,000 for the year ended December 31, 2010 compared to utilizing $2,002,000 last year. The primary cause for the cash utilized by operating activities during 2010 was operating losses.

Non-cash operating assets and liabilities provided $657,000 of cash during the current year, compared to providing $509,000 during 2009. The change in working capital occurred primarily as a result of growth in business. The Company continues to closely monitor accounts receivable in order to ensure cash is collected on a timely basis.

Cash Flows from Investing Activities

During the current year, the Company purchased capital assets totalling $1,228,000 as compared to $402,000 during the year ended December 31, 2009. The Company continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made. Expenditures incurred during 2010 were predominantly related to plant and equipment set up for the Joint Strike Fighter F-35 military jet aircraft program with BAE Systems for which product deliveries will commence in 2011.

Additionally, the Company invested $1,501,000 during the current year (December 31, 2009: $2,586,000) in tooling and new program introduction. Current year expenditures relate to investment in start-up costs for the Joint Strike Fighter F-35 military jet aircraft program. As noted below, this investment was fully funded by the customer.

Cash Flows from Financing Activities

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

During the year ended December 31, 2010, the Company's operating line of credit utilization decreased by $264,000 (December 31, 2009: $5,851,000 decreased utilization).

For the year ended December 31, 2010, proceeds from funding of program development amounted to $4,057,000 (December 31, 2009: $2,309,000).

Also during the current year, the Company repaid $1,035,000 of equipment financing (December 31, 2009: $1,321,000), and $90,000 in royalty repayments (December 31, 2009: $260,000).

On April 16, 2010, the Company issued a secured subordinated convertible loan with a principal amount of $1,771,000 which is currently convertible into a maximum of 29,516,666 common shares.

On March 1, 2010, the Company completed a private placement of 17,773,211 common shares at $0.055 per share for gross proceeds of $977,000. Subscribers in the private placement were Panta Holdings B.V., which has subscribed for 15,995,890 common shares, and Working Opportunity Fund (EVCC) Ltd., which has subscribed for 1,777,321 common shares.

On December 31, 2010, the ratio of the Company's current assets to current liabilities was 1.05:1 (December 31, 2009: 1.04:1), with the debt to equity ratio at 1.70:1 (December 31, 2009: 0.97:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	Total	2011	2012 – 2014	2015 – 2016	Post 2016
Convertible debenture	$ 4,554	$ 4,554[3]	$ -	$ -	$ -
Capital lease obligation	1,738	865	873	-	-
Convertible loan	2,303	-	-	2,303	-
Purchase obligation[1]	19,915	2,561	7,707	5,183	4,464
Other long-term obligations[2]	957	-	957	-	-
Total contractual obligations	29,467	7,980	9,537	7,486	4,464

1 Purchase obligations include payments for the Company's operating and property leases.
2 This amount represents obligations the Company has with Industrial Technologies Office.
3 The Company will not be obligated to pay any interest or principal until the debenture matures on March 31, 2011.
As at December 31, 2010, the Company was not in compliance with a financial covenant associated with the convertible debenture. The Company has obtained a waiver from the debt holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such future breach, the lender would be entitled to demand immediate payment. Accordingly, the convertible debenture is classified as current debt.

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

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

Capital Stock

Prior to December 31, 2008, holders of preferred shares converted 383,200 preferred shares resulting in 816,800 preferred shares remaining having a $8,168,000 gross book value, which net of $546,000 issuance costs results in a $7,622,000 net book value.

From July 1, 2008 to June 30, 2011, the preferred shares are 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.

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.

During June 2009, the Company's Board of Directors resolved to defer preferred share dividends from January 2009 until January 2011; during November 2010 it was resolved by the Board of Directors that this deferral of dividend payments be extended to the end of June 2011. Dividends paid during the year ended December 31, 2010 amounted to $Nil (December 31, 2009: $Nil). Unpaid dividends as at December 31, 2010 amounted to $1,512,000 (December 31, 2009: $756,000).

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 195,505,323 common shares issued and 1,141,512 reserved for issuance at December 31, 2010 pursuant to a convertible debenture, as well as 29,516,666 common shares under the provision of a convertible loan. The book value of common shares issued and outstanding as at December 31, 2010 was $76,042,000 (December 31, 2009: $74,601,000).

As at March 31, 2011, there were 195,505,323 common shares, 816,800 preference shares, and 8,766,000 stock options issued and outstanding.

New Accounting Policies

Business combinations and related sections

In January 2009, the Canadian Institute of Chartered Accountants (CICA) issued Section 1582 “Business Combinations” to replace Section 1581. Prospective application of the standard is effective January 1, 2011, with early adoption permitted. The new standard effectively harmonizes the business combinations standard under Canadian generally accepted accounting principles (CGAAP) with International Financial Reporting Standards (“IFRS”). The new standard revises guidance on the determination of the carry amount of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination.

The CICA concurrently issued Section 1601, “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests” which replace Section 1600 “Consolidated Financial Statements”. Section 1601 provides revised guidance in the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interest in consolidated financial statements subsequent to a business combination. These standards are effective January 1, 2011, unless they are early adopted at the same time as Section 1582. The Company has yet to determine the effect of adopting these standards.

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. On February 13, 2008, the Canadian Accounting Standards Board confirmed that publicly accountable entities will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011 with appropriate comparative data from the prior year. Under IFRS, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policies that will need to be addressed by management. As of the date of this report, 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 prepared a diagnostic identifying key areas where IFRS transition may have an impact. A technical analysis has been conducted in order to identify potential financial impacts thereby providing the platform upon which decisions on accounting policy choices have been made. Management has reviewed its business systems and determined that they are capable of processing and recording the transitional period reporting requirements. The transition to IFRS will require only minimal changes to internal controls. The transition to IFRS will require additional disclosures in the notes to the financial statements; this will not require significant changes to the current disclosure controls and procedures. As well, key employees have been trained in the new reporting standards, and a plan for adoption of IFRS has been executed.

The following International Accounting Standards (IAS) have been identified as potentially having an impact on historical values recorded under Canadian GAAP or future values to be recorded using IFRS. Not all potential financial adjustments have been subject to final concurrence by the Company’s Audit Committee.

IAS37 – Provisions

IAS 37 introduces concepts such as onerous contracts, constructive obligations and provisions. Although, these concepts are not explicitly defined in Canadian GAAP, any liabilities associated with these concepts already have been recorded in Avcorp’s Canadian GAAP statements. The analysis performed did not result in any new liabilities requiring recognition upon adoption of IFRS.

Under IAS 37, contingent losses are never recognized and are instead disclosed; unless the possibility of economic outflow in settlement is remote in which case a disclosure is not made. With Canadian GAAP contingent losses are recognized if they are likely to occur. Avcorp does not have any contingent liabilities at transition date.

IAS36 – Impairments

Avcorp experienced significant operating losses during 2010, and the book value of its assets as at December 31, 2010 exceeded the market capitalization of the company’s common shares. Consequently, an impairment review was required. Avcorp has two cash generating units (CGU): Avcorp and Comtek. Under IFRS, the assets of the CGU are compared to the greater of: the value in use model, which is typically determined by a discounted cash flow; and the fair value less costs to sell model. Where either of these two valuation models supports the recoverable amount of the assets, no impairment is recorded.

The impairment analysis under IFRS indicates that there is an impairment of long-lived assets for Comtek. Given the degree of estimates required in this analysis it would be prudent to record this impairment at the first point in time that the impairment becomes significant; 2010 Q1. The impairment would be applied as a partial write-down of Comtek intangibles.

IAS16 – Property, Plant & Equipment

IFRS states that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. This is referred to as component depreciation. Although Canadian GAAP is conceptually consistent with IFRS, it is not as prescriptive as IFRS. Within the context of materiality, Management has reviewed all assets having a cost in excess of $100,000 for the existence of a separate component to be evaluated. Each component in the detailed fixed asset listing has been quantified and depreciation calculated based on its useful life.

The cost of the most significant component identified is $86,000 (incorporated into $1,667,000 cost of equipment). The incremental depreciation which would be recorded for all components identified would amount to $10,000 per year. Avcorp is not recommending any change in calculation of depreciation for its existing equipment.

IAS21 – Functional Currency

Avcorp's cost and the financing indicators are the most clear indicators of functional currency, and these point towards a Canadian dollar functional currency. The sales indicator is less conclusive, as there are Canadian market influences, in particular in respect of the regulatory aerospace environment. The financing indicator clearly points towards the Canadian dollar. Retention of receipts is inconclusive as funds are moved between US dollar and Canadian dollar accounts. Consequently the functional currency of Avcorp would be the Canadian dollar.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2010 were at planned levels for Bombardier and Boeing programs. Within the supply chain for Cessna programs, as well as a manufacturing deficiency for an Aviation Partners Boeing program, the Company experienced quality issues giving rise to warranty expenditures, for which the Company has implemented corrective and preventive measures.

Order Backlog

The Company operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's agreements with Boeing Commercial Airplane Group extend from January 2007 to December 2012. Agreements with Boeing Defense, Space and Security extend to December 31, 2012, and BAE Systems (Operations) Limited (BAE) to December 21, 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 agreements based on manufacturers' projections and current degrees of exclusivity. The order backlog, as at December 31, 2010, was $251 million, ($64 million of which pertains to 2011), compared to $276 million as at December 31, 2009. The changes in order backlog are as follows:

- $77 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2010;
- $67 million increase in order backlog primarily due to production rate increases of various existing programs; and
- $15 million decrease in order backlog resulting from changes in the value of the Canadian dollar relative to the US dollar for the Company's US dollar denominated sales. Refer to comments on currency risk.

The Company and Cessna have announced that the current production work will be transitioned back to Cessna. The Company will continue to fulfill orders until transition. Cessna has currently placed orders for the entire 2011 year. Discussion have not yet produced a definitive agreement with respect to the timing for the transition and associated expenses in connection with the transition. Cessna program revenues comprise $86 million of the total Company order backlog.

Supply Chain

Vendor quality performance generally met targeted levels during the year, 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. The Company will continue to work closely with our supply chain to ensure a stable, uninterrupted delivery of compliant products and is making changes in product sourcing processes where necessary.

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. The securing of additional long-term contracts with key suppliers continues. The Company is in the process of setting up a comprehensive supply chain for the F35 Outboard Wing program.

Working Capital Utilization

Total current assets less total current liabilities was in a surplus position of $1,316,000 at December 31, 2010 and a surplus of $820,000 at December 31, 2009. The change in position during 2010 was primarily due to financing activities via equity and convertible debt financings.

Financial Resources

The Company has invested in its chosen strategies of organic growth, lean manufacturing and strategic sourcing. Management believes that 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 will position 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, 2010 was 562 (December 31, 2009: 473). The growth in the number of employees is attributable to the restart of dormant programs and full rate production on new programs which were entered into in 2009. 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 have reached their completion, within which production was re-started with productivity at targeted levels.

Technology upgrades in high-speed machining have occurred in the past two years. 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:

- additional financing is required to maintain its business;
- increases in material costs, primarily aluminum plate, titanium, sandwich panels 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;
- consolidation and globalization by competitors;
- potential failure to achieve cost-reduction objectives relative to revenue growth;
- the trend to greater use of composite material in primary structures in each new generation of aircraft; and
- increases in the value of the Canadian dollar, relative to the US dollar, has an adverse effect on the Canadian dollar equivalent value of the Company's revenues which are denominated in US dollars.

The Company's view is that with the refinancing completed and in process, the continued integration of composite design and manufacturing capabilities, and a strategic plan in place the Company should be in a position to face and mitigate these risks. However, there can be no assurance that the Company will be successful with all initiatives.

Additional Financing

The Company's growth strategy requires continued access to capital. From time to time, the Company may require additional financing to enable it to:

- finance unanticipated working capital requirements;
- finance new program development and introduction;
- develop or enhance existing services and capabilities; or
- respond to competitive pressures.

The Company cannot provide assurance that, if it needs to raise additional funds, such funds will be available on favorable terms, or at all. If the Company cannot raise adequate funds on acceptable terms, its business could be materially harmed.

Also certain financing agreements are due for repayment under certain conditions:

On July 27, 2010, the Company entered into an Amending Agreement to the Forbearance Agreement with the bank providing its operating lines of credit. The Forbearance Agreement ended on October 15, 2010. The Company is subject to a quarterly review by the bank. The Company is currently in the process of renegotiating a renewal of the Forbearance Agreement.

As at December 31, 2010, the Company was not in compliance with the tangible net worth and debt service coverage financial covenants associated with the convertible debenture. The Company has obtained a waiver from the debt holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. Principal and interest on this loan are due on March 31, 2011.

The Company has deferred and therefore not paid $1,512,000 of preferred share dividends which were accrued and payable as at December 31, 2010 (December 31, 2009: $756,000). On July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, will be redeemable at the option of the holder in whole.

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. In addition, 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.

The Company is engaging suppliers and customers to properly align requirements, ensuring uninterrupted delivery of compliant products. Changes in forecasts are closely monitored in order to promptly adjust procured materials and parts quantities with the objective of limiting unwanted inventory build-up.

Aircraft Production Rates

The following industry and program trends impact the Company.

- Company research indicates that the aerostructures markets for commercial aircraft and business jets will start to grow again in 2011. This research also indicates that this recovery will continue into 2012 and 2013. The market for defence aircraft is also expected to continue to grow in 2011 and into 2012.
- Recovery of air travel rates and reduced airline capacity will increase rates on the Boeing 737 and Airbus A320 late in 2011, early 2012.
- The production of the Boeing 757 wing adapter plug for winglet retrofits is expected to continue at its reduced rate.
- Bombardier Challenger 850 and the Challenger 605 business jet aircraft production remain flat into 2011. The rates for Bombardier's regional aircraft are expected to be at similar levels for 2011 compared to 2010.
- Cessna Citation Sovereign and CJ3 business jet rates decreased significantly in 2009, and sales in this market segment is now expected to show modest recovery in 2011 and 2012. The introduction of the CJ4 is progressing as planned showing continuous growth.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exists to provide additional revenue from this aerospace sector.

Competitors

Despite the current economic conditions, the long-term trend continues towards more intense competition from larger entities having operations in Asia, Mexico 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 negotiated a new 3 year collective agreement with its labour force which came into effect on April 1, 2010 and will expire on March 13, 2013.

The Company continues to focus on cost reductions for direct labour, material and overhead. These cost reductions will be achieved through continuous improvements in the internal and external parts supply chain using lean manufacturing technology, through continued negotiation of long-term agreements for the majority of key suppliers, through increased efficiency of plant capacity augmented by technological improvements, and through continued focus on cost targets at all levels of the organization. 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. However, fixed overhead costs continue to have an adverse impact on the Company's cost structure during this period of reduced revenues.

Composite Materials

Through its subsidiary Comtek, the Company has ongoing operations expertise in the design and competitive manufacture and repair 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.

US Dollar Revenues

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. As the value of the Canadian dollar strengthens, the equivalent value of US dollar denominated revenues decreases. The Company is commencing to structure new agreements with customers which mitigate the risk associated with currency fluctuations.

Outlook

Variability of the Canadian dollar relative to the US dollar continues to cause the value of the Company's current order backlog to fluctuate. The Company continues to work towards securing additional defence programs in order to augment and diversify its backlog. The Company began delivering products under its military contracts in 2009 and is currently negotiating long-term supply agreements. Assuming long-term agreements are secured, the Company believes that revenues from its military customers will increase to 2013 and extend past 2020. The Company expects to primarily finance investment in the start-up of new military defence programs with milestone payments from customers, though this cannot be assured. Boeing will be the Company's largest customer in 2011, followed by Cessna and Bombardier.

The Company forecasts its 2011 revenue levels to be increased over 2010 primarily as a result of production rate increases in various Customer programs as well as introduction of new programs. With the exception of capital expenditures required for new programs, the Company's investment in new equipment will be maintained at 2010 levels. The Company rehired a significant portion of its workforce to meet increased 2010 and 2011 customer delivery requirements.

The Company forecasts its financing requirements for 2011 to exceed the current availability of the operating line of credit. Accordingly, the Company has completed a private placement and obtained additional debt financing. However, further debt and equity financing may be required.

As at December 31, 2010, the Company was not in compliance with financial covenants 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 the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment.

Also, as at December 31, 2010, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada. The Company has obtained a waiver from the debenture holder for this non-compliance. However, the Company expects future breaches which would result in the lender being entitled to demand payment. Principal and interest on this loan are due March 31, 2011.

The Company has deferred and therefore not paid $1,512,000 of preferred share dividends which were accrued and payable as at December 31, 2010 (December 31, 2009: $756,000). On July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, will be redeemable at the option of the holder in whole.

The Company currently is in the process of negotiating the re-financing of the above-noted financial arrangements.

Transactions with Related Parties

The former Chairman of the Board and shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. As at October 7, 2009, the guarantee was reduced to $1,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company paid a fee of 20% per annum on the remaining $1,000,000 limited guarantee calculated on a daily basis. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2010 amounted to $200,000 (December 31, 2009: $300,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2010 are $Nil (December 31, 2009: $Nil). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $200,000 for the year ended December 31, 2010 (December 31, 2009: $200,000).

During the year ended December 31, 2010, consulting services were provided by certain directors. Fees paid to certain directors, or Companies with which they have beneficial ownership, during the year ended December 31, 2010 amounted to $80,000 (December 31, 2009: $85,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2010 are $2,000 (December 31, 2009: $10,000). These fees are included in the Statements of Operations as administrative and general expenses and amount to $72,000 for the year ended December 31, 2010 (December 31, 2009: $95,000).

Fourth Quarter

The following summarizes financial results for the fourth quarter 2010.

Operating losses for the fourth quarter of 2010 were $1,290,000 from $19,364,000 in revenues, as compared to operating losses of $1,936,000 from $16,641,000 in revenues for the quarter ended December 31, 2009. The major contributing cause to an operating loss for the fourth quarter of 2010 was $951,000 expensed during the quarter as a result of idle plant capacity. EBITDA loss decreased from negative $1,377,000 in the fourth quarter of 2009 to negative EBITDA of $1,329,000 for the same quarter this year.

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, 2010 provision for anticipated losses was $878,000 (December 31, 2009: $1,080,000). The decrease in this provision from December 31, 2009 was primarily as a result of a reduction in the anticipated number of aircraft components to be delivered.
- 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 $5,181,000 (December 31, 2009: $3,923,000). These costs are to be amortized over the number of units which management believes is a best estimate of deliveries for the programs to the customer, based on currently available customer provided information. 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.
- During 2010, the Company provisioned $417,000 of expect warranty expenditures relating to a manufacturing deficiency within its supply chain with a sub-contractor. All rectifications have not been completed by the date of this report, and $35,000 remains provisioned for expected future expenditures.
- During 2010, the Company provisioned for $428,000 of expected warranty expenditures relating to a manufacturing deficiency. All rectifications have not been completed by the date of this report, and $132,000 remains provisioned for expected future expenditures.
- A customer advised the Company that an expected repair of a product delivered in previous years did not require any further rework. Accordingly, the estimated warranty provision recorded in 2007 was reversed.

Measurement Uncertainty:

The preparation of the accompanying financial statements required management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. By their nature these estimates are subject to measurement uncertainty. The effect on the financial statements of changes in such estimates in future periods could be material and would be accounted for in the period the change occurs.

- Carrying Value of long-lived assets – The Company holds property, plant and equipment on the balance sheet amounting to $14,794,000 (December 31, 2009: $19,164,000). The recoverability of the carrying value of these assets is, in part, dependant on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on delivering to the scheduled production ramp-up for new defence programs, as well as dependant on market conditions including demand for such aircraft for which the Company provides its products.
- Recoverability of deferred tooling costs – The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2010, $5,181,000 (December 31, 2009: $3,923,000) in unamortized deferred tooling costs, which are expected to be recoverable from the related future cash flows of operations resulting from continued customer orders or recovery of cash from customers for deferred amounts, are presented as Development Costs in the balance sheet.
- In accordance with Canadian GAAP the carrying value of long-lived assets is tested for impairment. Circumstances such as the decline in the Company's share price, the significant reduction in customer orders, and the financial condition of the Company may exist and indicate that the carrying amount of long-lived assets may not be recoverable. The aforementioned circumstances existed for the Company as at December 31, 2010 indicating that an assessment for impairment was required. An impairment assessment was made which considered the undiscounted cash flows from forecasted customer orders. The result of the impairment assessment indicated that long-lived assets were recoverable from forecasted future cash flows.

Financial Instruments and Other Instruments

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 3%. The maximum operating line of credit availability is $15,000,000. 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, 2010, with other variables unchanged, a 1% change in the bank prime interest rate would have a $82,000 (December 31, 2009: $84,000) 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 2010 was $43,000 as compared to a $4,412,000 gain for the year ended December 31, 2009.

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

	2010	2009
Accounts receivable	$ 4,856	$ 4,028
Bank cash position	5,674	-
Bank indebtedness	-	1,129
Accounts payable	542	829
Long-term debt	1,294	1,865

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in an increase (decrease) of approximately $869,000 in net earnings for the year ended December 31, 2010 (December 31, 2009: $20,000) as a result of holding a US dollar net asset position.

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), Boeing Defense, Space & Security (BDS), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna). The maximum exposure to credit risk is represented by the amount of accounts receivable in the balance sheet.

As at the balance sheet date 81% (December 31, 2009: 65%) of the Company's trade accounts receivable are attributable to these customers.

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 seeks to manage liquidity risk through the management of its capital structure and financial leverage as outlined in the Liquidity and Capital Resource discussions, as well as the Going Concern discussion.

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, 2010 and concluded that the Company's current disclosure controls and procedures as well as the internal controls over financial reporting 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, 2010, 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 ability of the Company to renegotiate its debt agreements under which it is in default; (b) the extent to which the Company is able to achieve savings from its restructuring plans; (c) uncertainty in estimating the amount and timing of restructuring charges and related costs; (d) changes in worldwide economic and political conditions that impact interest and foreign exchange rates; (e) the occurrence of work stoppages and strikes at key facilities of the Company or the Company's customers or suppliers; (f) government funding and program approvals affecting products being developed or sold under government programs; (g) cost and delivery performance under various program and development contracts; (h) the adequacy of cost estimates for various customer care programs including servicing warranties; (i) the ability to control costs and successful implementation of various cost reduction programs; (j) the timing of certifications of new aircraft products; (k) the occurrence of further downturns in customer markets to which the Company products are sold or supplied or where the Company offers financing; (l) changes in aircraft delivery schedules or cancellation of orders; (m) the Company's ability to offset, through cost reductions, raw material price increases and pricing pressure brought by original equipment manufacturer customers; (n) the availability and cost of insurance; (o) the Company's ability to maintain portfolio credit quality; (p) the Company's access to debt financing at competitive rates; and (q) 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 (GAAP) 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, the system of internal control 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

Independent Auditor's Report

To the Shareholders of Avcorp Industries Inc.

We have audited the accompanying consolidated financial statements of Avcorp Industries Inc. and its subsidiary (the "Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations and comprehensive loss and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Avcorp Industries Inc. and its subsidiary as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which describes the matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

PricewaterhouseCoopers LLP	PRICEWATERHOUSECOOPERS LLP Chartered Accountants

Vancouver, British Columbia
March 31, 2011

Consolidated Balance Sheets
as at December 31, 2010 and December 31, 2009
(in thousands of Canadian dollars)

	December 31, 2010	December 31, 2009
Assets		
Current assets		
Accounts receivable	$ 8,869	$ 6,689
Inventories (note 7)	14,886	15,497
Prepayments	1,922	1,092
Other assets (note 6e)	28	24
	25,705	23,302
Development costs (note 8)	5,181	3,923
Property, plant and equipment (note 9)	14,794	17,346
Warranty claim receivable (note 22)	-	1,637
Intangible assets (note 10)	-	1,818
	45,680	48,026
Liabilities		
Current liabilities		
Bank indebtedness (note 11)	8,158	8,422
Accounts payable and accrued liabilities	10,811	7,929
Current portion of long-term debt (note 14)	5,420	6,131
	24,389	22,482
Deferred gain	358	405
Lease inducement (note 13)	764	863
Deferred tooling revenues (note 12)	6,804	3,116
Long-term debt (note 14)	3,275	1,811
Warranty provision (note 22)	167	1,647
Future income tax liability	0	858
	35,757	31,182
Shareholders' Equity		
Capital stock (note 16)	72,927	71,954
Equity component of convertible loan (note 14d)	453	-
Preferred shares (note 17)	7,622	7,622
Contributed surplus	2,662	2,647
Deficit	(73,741)	(65,379)
	9,923	16,844
	45,680	48,026

Nature of operations and going concern (note 1)
Measurement uncertainty (note 3)
Obligation and commitments under capital and operating leases (note 15)

Approved by the Board of Directors

David Levi
Chairman

Eric Kohn
Committee Chair,
Audit & Corporate Governance Committee

Consolidated Statements of Operations and Comprehensive Loss

For the years ended December 31, 2010 and 2009
(in thousands of Canadian dollars, except number of shares and per share amounts)

For the year ended December 31	2010	2009
Revenues	$ 77,258	$ 69,202
Cost of sales and expenses		
Cost of sales	67,889	64,555
Administrative and general expenses	10,842	10,477
Amortization and depreciation	3,761	4,083
Foreign exchange loss (gain) (note 6a)	43	(4,412)
	82,535	74,703
Income (Loss) from operations	(5,277)	(5,501)
Interest expense and financing charges (note 20)	(1,361)	(1,739)
Unrealized derivative gain (loss) (note 6e)	5	(705)
Write-down of equipment (note 9)	(349)	(793)
Write-down of intangible assets	(1,482)	-
Loss before income taxes	(8,464)	(8,738)
Future Income Tax Recovery	858	328
Loss and comprehensive loss for the period	(7,606)	(8,410)
Basic and diluted loss per common share	(0.04)	(0.12)
Basic weighted average number of shares outstanding (000's)	192,632	69,632
Diluted weighted average number of shares outstanding (000's)	193,507	69,632

Consolidated Statements of Deficit

For the years ended December 31, 2010 and 2009
(in thousands of Canadian dollars)

For the year ended December 31	2010	2009
Deficit – Beginning of period	$ (65,379)	$ (56,213)
Income (Loss) for the period	(7,606)	(8,410)
Preferred share dividends	(756)	(756)
Deficit – End of period	(73,741)	(65,379)

Consolidated Statements of Cash Flows
For the years ended December 31, 2010 and 2009
(in thousands of Canadian dollars)

For the year ended December 31	2010	2009
Cash flows from operating activities		
Income (Loss) for the period	$ (7,606)	$ (8,410)
Items not affecting cash (note 21a)	4,255	6,408
	(3,351)	(2,002)
Change in non-cash items related to operating activities (note 21b)	657	509
	(2,694)	(1,493)
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,228)	(402)
Proceeds from disposal of property, plant and equipment	11	58
Payments relating to development costs and tooling	(1,501)	(2,586)
	(2,718)	(2,930)
Cash flows from financing activities		
Net increase or (repayment) of bank indebtedness	(264)	(5,851)
Proceeds from customer funding of program development and tooling	4,057	2,309
Proceeds from current and long-term debt	1,771	5,952
Repayment of current and long-term debt	(1,125)	(2,738)
Issue of common shares	977	5,244
Share issue expense	(4)	(493)
	5,412	4,423
Net change in cash and cash equivalents	-	-
Cash and cash equivalents - Beginning of period	-	-
Cash and cash equivalents - End of period	-	-
Interest paid	801	1,300

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, 2010, the Company recorded a net loss of $7,606,000 on $77,258,000 revenue, as compared to a net loss of $8,410,000 on $69,202,000 revenue for the year ended December 31, 2009 and has incurred negative cash flow from operating activities in both years (December 31, 2010: $2,694,000, December 31, 2009: $1,493,000). The Company has a working capital surplus of $1,316,000 as at December 31, 2010 (December 31, 2009: $820,000 surplus) and an accumulated deficit of $73,741,000 at December 31, 2010 (December 31, 2009: $65,379,000).

As at December 31, 2010, the Company was not in compliance with financial covenants 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 the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment.

Also, as at December 31, 2010, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada (note 14a). The Company has obtained a waiver from the debenture holder for this non-compliance. However, the Company expects future breaches which would result in the lender being entitled to demand payment. Principal and interest on this loan are due March 31, 2011.

The Company has deferred and therefore not paid $1,512,000 of preferred share dividends which were accrued and payable as at December 31, 2010 (December 31, 2009: $756,000). On July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, will be redeemable at the option of the holder in whole (note 17).

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 in the next 12 months to exceed the current availability of the operating line of credit. During 2010, the Company completed a private placement (note 16b) and secured subordinated convertible loan (note 14d), and will continue its efforts to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, secure additional revenue generating contracts, and reduce operating expenses 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

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

Basis of consolidation

The consolidated financial statements of the Company include the accounts of Avcorp Industries Inc. and its subsidiary Comtek Advanced Structures Ltd. All significant intercompany transactions and balances have been eliminated.

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 amounts which are reported in the consolidated financial statements 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.

Revenue

Revenue from recurring production contracts 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 cost of equity options and other stock-based compensation arrangements are estimated at fair value at the grant date using the Black-Scholes valuation method 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 substantively enacted 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.

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 was received from Industrial Technologies Office. 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

Intangible assets

Intangible assets are comprised of the fair value of customer relationships, 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.

Impairment of long-lived assets including depreciable intangible assets

Management assesses depreciable intangible assets and property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Management recognizes an impairment loss when the carrying amount exceeds the projected undiscounted future net cash flows expected from their 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. Estimated cash flows are calculated based on projected orders, selling prices and operating costs including an allocation of fixed costs. 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.

Convertible loans and debentures

Upon issuance, convertible debentures and loans are classified into their equity and liability components based on the fair value of debt element, with the residual of the gross proceeds allocated to equity. 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.

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 Measurement Uncertainty

The preparation of these financial statements required management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. By their nature these estimates are subject to measurement uncertainty. The effect on the financial statements of changes in such estimates in future periods could be material and would be accounted for in the period the change occurs.

- Carrying value of long-lived assets

  The Company holds property, plant and equipment, (note 9) on the balance sheet amounting to $14,794,000 (December 31, 2009: $19,164,000). Recent market demand for aircraft has resulted in negative operating cash flows in 2009 and 2010. The recoverability of these assets is dependent on the ability of the company to generate sufficient cash flow from operations over the remaining useful life of the assets, which is contingent on, amongst other factors, the ability of the Company to replace known program losses with new programs as well as ramping up scheduled production for new defence contracts. The recoverability of the carrying value of these assets is, in part, dependant on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on delivering to the scheduled production ramp-up for new defence programs, as well as dependant on market conditions including demand for such aircraft for which the Company provides its products.

- Recoverability of deferred tooling costs

  The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2010, $5,181,000 (December 31, 2009: $3,923,000) in unamortized deferred tooling costs (note 8), which are expected to be recoverable from the related future cash flows of operations resulting from continued customer orders or recovery of cash from customers for deferred amounts, are presented as Development Costs in the balance sheet.

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

4 Accounting

New accounting policies:

Business combinations and related sections

In January 2009, the Canadian Institute of Chartered Accountants (CICA) issued Section 1582 "Business Combinations" to replace Section 1581. Prospective application of the standard is effective January 1, 2011, with early adoption permitted. The new standard effectively harmonizes the business combinations standard under Canadian generally accepted accounting principles (CGAAP) with International Financial Reporting Standards (IFRS). The new standard revises guidance on the determination of the carry amount of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination.

The CICA concurrently issued Section 1601, "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests" which replace Section 1600 "Consolidated Financial Statements". Section 1601 provides revised guidance in the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interest in consolidated financial statements subsequent to a business combination. These standards are effective January 1, 2011, unless they are early adopted at the same time as Section 1582. The Company has yet to determine the effect of adopting these standards.

5 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 (notes 14 and 16). 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 (notes 11 and 14a). Other matters relating to liquidity and capital risk management are set out in note 1.

6 Financial Risk Management

The Company is exposed to certain financial risks including currency risk, credit risk, liquidity risk, interest rate risk and price 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 2010 was $43,000 as compared to a $4,412,000 gain for the year ended December 31, 2009.

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

	2010	2009
Accounts receivable	$ 4,856	$ 4,028
Bank cash position	5,674	-
Bank indebtedness	-	1,129
Accounts payable	542	829
Long-term debt	1,294	1,865

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in an increase (decrease) of approximately $869,000 in net earnings for the year ended December 31, 2010 (December 31, 2009: $20,000) as a result of holding a US dollar net asset position.

Foreign Exchange Forward Contracts

During 2008, the Company entered into USD25,000,000 of foreign-exchange-forward contracts which were executed during 2009, with the provider of its operating lines of credit. No such instruments were in place as at December 31, 2010 and 2009. Accordingly, the Company has not recorded a derivative gain or loss during the year ended December 31, 2010 (December 31, 2009: $708,000 loss).

b) 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), Boeing Defense, Space & Security (BDS), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna). The maximum exposure to credit risk is represented by the amount of accounts receivable in the balance sheet.

As at the balance sheet date 81% (December 31, 2009: 65%) of the Company's trade accounts receivable are attributable to these customers.

c) 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 seeks to manage liquidity risk through the management of its capital structure and financial leverage as outlined in note 5 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. Preferred shares are redeemable as outlined in note 17.

d) 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 3% (note 11). The maximum operating line of credit availability is $15,000,000. 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, 2010, with other variables unchanged, a 1% change in the bank prime interest rate would have a $82,000 (December 31, 2009: $84,000) impact on net earnings or cash.

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

e) Price Risk

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, 2010, the Company has $24,196,000 (December 31, 2009: $4,442,000) of firmly committed orders that include price adjustment clauses of this nature. A $7,000 gain has been recorded in unrealized derivative gain (loss) for the year ended December 31, 2010 as compared to a $4,000 gain for the year ended December 31, 2009 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, 2010, the Company has $324,000

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

(December 31, 2009: $445,000) of firmly committed purchases that include price adjustment clauses of this nature. A $2,000 loss has been recorded in unrealized derivative income for the year ended December 31, 2010 as compared to a $1,000 loss for the year ended December 31, 2009 as a result of the change in the fair value of the underlying embedded derivatives.

Other Assets and Liabilities

Other assets are comprised of $28,000 inflation derivatives assets arising from the Company's sales and purchase contracts having price adjustment clauses within their terms (December 31, 2009: $24,000).

f) Financial Assets and Liabilities by Category

As at December 31, 2010 and 2009, the Company's financial assets and liabilities are categorized as follows:

	December 31, 2010			
	Loans and receivables	Held at fair value	Financial assets and liabilities at amortized cost	Total
Financial Assets				
Accounts receivable	$8,869	$ -	$ -	$ 8,869
Warranty claim receivable	1,776	-	-	1,776
Commodity contracts	-	28	-	28
Financial Liabilities				
Bank indebtedness	-	-	8,158	8,158
Accounts payable and accrued liabilities	-	-	10,811	10,811
Long-term debt	-	-	9,094	9,094

	December 31, 2009			
	Loans and receivables	Held at fair value	Financial assets and liabilities at amortized cost	Total
Financial Assets				
Accounts receivable	$ 6,689	$ -	$ -	$ 6,689
Warranty claim receivable	1,637	-	-	1,637
Currency and commodity contracts	-	24	-	24
Financial Liabilities				
Bank indebtedness	-	-	8,422	8,422
Accounts payable and accrued liabilities	-	-	7,929	7,929
Long-term debt	-	-	7,942	7,942

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 long-term debt approximate their carrying values prior to giving effect to the Company's current financial condition.

7 Inventories

	December 31, 2010	December 31, 2009
Raw materials	$ 6,458	$ 6,419
Work in progress	7,964	8,646
Finished products	464	432
	14,886	15,497

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

The amount of inventory expensed in cost of sales during the year ended December 31, 2010 amounted to $63,454,000. The carrying value of inventory pledged as security as at December 31, 2010 is $14,886,000.

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, 2010 provision for anticipated losses was $878,000 (December 31, 2009: $1,080,000). Work in progress inventory noted in the above table has been net of these provisions for anticipated losses.

As at December 31, 2010, the Company provisioned $32,000 for costs incurred in excess of the net realizable value of finished goods inventory (December 31, 2009: $73,000). Finished goods inventory noted in the above table has been net of these provisions for anticipated losses.

8 Development Costs

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

	December 31, 2010	December 31, 2009
Opening balance	$ 3,923	$ 3,299
Additions	1,501	712
Amortization	(243)	(88)
	5,181	3,923

9 Property, Plant and Equipment

	December 31, 2010			December 31, 2009		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Computer hardware and software	$ 8,226	$ 6,413	$ 1,813	$ 7,608	$ 5,655	$ 1,953
Machinery and equipment	36,243	23,840	12,403	35,704	20,832	14,872
Leasehold improvements	1,081	503	578	985	464	521
	45,550	30,756	14,794	44,297	26,951	17,346

Included in computer hardware and software are assets held under capital leases at a cost of $1,395,000 (2009: $1,395,000) having accumulated depreciation of $1,225,000 (2009: $931,000).

Included in machinery and equipment are assets held under capital leases at a cost of $5,026,000 (2009: $5,006,000) having accumulated depreciation of $1,075,000 (2009: $735,000).

Also included in machinery and equipment is aircraft tooling which will be amortized to cost of sales, on a unit-of-production basis over the expected life of the program or the contract period for the program. Machinery and equipment includes $5,462,000 of costs incurred under development projects which were completed during previous years and subsequently reclassified from Development Costs (note 8).

Included in leasehold improvements are assets held under capital leases at a cost of $52,000 (2009: $52,000) having accumulated depreciation of $16,000 (2009: $11,000).

During 2010 the value of certain equipment was written down by $349,000 (December 31, 2009: $793,000). The equipment which was no longer in use had a cost of $421,000, and an accumulated depreciation of $135,000; resulting in a $286,000 charge against income. A change in estimated value of other equipment amounted to a $63,000 charge against income.

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

10 Intangible Assets

	Remaining Estimated Useful Lives (years)	December 31, 2010			December 31, 2009		
		Cost	Accumulated Amortization	Net	Cost	Accumulated amortization	Net
Customer relationships	4	$ 1,320	$ 566	$ 754	$ 1,320	$ 378	$ 942
Trade name	2	300	180	120	300	120	180
Patents	7	870	262	608	870	174	696
Write-down of intangible assets	-	-	1,482	(1,482)	-	-	-
		2,490	2,490	0	2,490	672	1,818

Revenues generated by the Company's subsidiary Comtek Advanced Structures Ltd. declined during 2010 indicating that the carrying amount of its intangible assets may not be recoverable. Consequently an impairment test of those assets was conducted whereby the subsidiary's expected future cash flows were assessed.

Based on the declining historic cash flows of the reporting unit, and estimated future cash flows from actual and expected revenues it was estimated that cash flows would be insufficient to recover the carrying value of the intangible assets. A full write-down of the $1,482,000 carrying amount of the intangible assets has been recorded as at December 31, 2010.

11 Bank Indebtedness

The Company has operating lines of credit with a Canadian chartered bank totalling $15,000,000 (December 31, 2009: $15,000,000). The facilities are due on demand.

As a condition of obtaining these operating lines of credit, the following terms were established:

- 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;
- the credit available to the Company under its operating lines of credit shall be equal to the amount determined by the margin formula currently in place less $1,000,000 until such time as an equivalent amount is guaranteed by a party acceptable to the bank (note 24a). The Company is in discussions with the bank to find replacement security;
- interest at Bank prime plus 3.0%; and
- the Company shall pay the Bank a monthly forbearance fee of $10,000;

The Company is required to maintain certain measures of working capital, debt to tangible net worth, net worth, and debt service coverage. As at December 31, 2010, the Company was not in compliance with the net worth and debt service coverage financial covenants. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. The Company has not obtained a waiver for these breaches and as a result the bank is entitled to demand immediate payment.

On July 27, 2010, the Company entered into an Amending Agreement to the Forbearance Agreement with the bank providing its operating lines of credit. The Forbearance Agreement ended on October 15, 2010. The Company is subject to a quarterly review by the bank. The Company is currently in the process of renegotiating a renewal of the Forbearance Agreement.

12 Deferred Tooling Revenues

	December 31, 2010	December 31, 2009
Opening balance	$ 3,116	$ 1,173
Additions	4,522	2,648
Amortization	(834)	(705)
	6,804	3,116

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

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. Additionally, customers have funded the non-recurring costs incurred during the introduction of new production programs. These costs are deferred as development costs and will be charged to income in conjunction with the associated deferred revenue upon commencement of production.

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. The lease inducement credit is being amortized against rental expense over the term of the lease. It has an unamortized balance of $764,000 as at December 31, 2010 (December 31, 2009: $863,000).

14 Long-Term Debt

	December 31, 2010	December 31, 2009
Convertible debenture (a)	$ 4,554	$ 4,338
Capital leases (b)	1,738	2,689
Accrued government royalties (c)	957	915
Convertible loan (d)	1,446	-
	8,695	7,942
Less: Current portion	(5,420)	(6,131)
	3,275	1,811

a) Export Development Canada Convertible Debenture

The principal outstanding debenture amount of $4,338,000 is convertible at the option of the holder (Export Development Canada) into 1,141,512 shares at a conversion price of $3.80. 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.

The debenture bears interest at 5.0% per annum and is unsecured.

Principal and accrued interest are due on March 31, 2011. The Company is currently in negotiations with the debenture holder to amend repayment terms.

The Company is required to maintain certain measures of working capital, tangible net worth, debt to tangible net worth, and debt service coverage.

As at December 31, 2010, the Company was not in compliance with the tangible net worth and debt service coverage financial covenants associated with the convertible debenture. The Company has obtained a waiver from the debt holder for this non-compliance; it has not obtained a waiver for anticipated future breaches.

b) Capital Leases

There are various equipment leases that have a weighted average interest rate of 7.08% 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 (note 15). $1,738,000 of the leases are held in US dollars.

c) Accrued Government Royalties

Royalties of $957,000 (December 31, 2009: $915,000) are payable to Industrial Technologies Office. On February 5, 2010, the Company signed an amended agreement with Industrial Technologies Office deferring commencement of royalty repayments to April 30, 2012 and subsequent years.

d) Convertible Loan

On April 16, 2010, the Company completed a secured subordinated convertible loan with a principal amount of $1,771,000 which is currently convertible into a maximum of 29,516,666 common shares.

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

The secured subordinated convertible loan has been provided by Panta Holdings B.V. through a wholly-owned subsidiary. The loan, which is evidenced by a promissory note, has a five year term with an interest rate of 6% per year; it is secured by a security interest in all of the Company's present and after-acquired personal property and a floating charge on land which will rank subordinate to all liens, charges and security interests disclosed. The $1,771,000 principal amount is convertible into common shares at a conversion price of $0.06 per common share in the first two years of the loan, $0.07 per common share in the third and fourth years of the loan, and $0.08 per common share in the fifth year of the loan. Accumulated interest is not convertible.

The loan has been classified into its debt and equity components using the credit adjusted rate. The carrying amount of the financial liability is first determined by discounting the stream of future principal and interest payments at the rate of interest (12.0%) as specified within the convertible loan agreement under circumstances which would have taken effect where the convertibility feature had not been approved by a vote of the common shareholders. The equity component equals the amount determined by deducting from the carrying amount of the compound instrument the amount of the debt component. For accounting purposes, the debt component was assigned a value of $1,318,000 and the conversion rights were assigned a value of $453,000.

Interest expense on the debentures is composed of the interest calculated on the face value of the debentures which amounted to $74,000 as at December 31, 2010, and an annual notional interest representing the accretion of the carrying value of the debentures which amounted to $54,000.

	December 31, 2010	December 31, 2009
Principle amount of convertible loan	$ 1,771	$ -
Accrued interest	74	-
Less equity component of convertible loan	(453)	-
Accreted interest	54	-
Liability component	1,446	-

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:

	December 31, 2010		December 31, 2009	
	Operating	Capital	Operating	Capital
2010	$ -	$ -	$ 2,397	$ 1,036
2011	2,561	961	2,620	1,022
2012	2,573	686	2,566	723
2013	2,568	224	2,564	94
2014	2,566	-	2,564	-
2015	2,584	-	2,584	-
Thereafter	7,065	-	7,065	-
Total future minimum lease payments	19,917	1,871	22,360	2,875
Less: Imputed interest	n/a	(133)	n/a	(186)
Balance of obligation under capital leases included in long-term debt (note 14b)	-	1,738	n/a	2,689

For the year ended December 31, 2010, an amount of $2,074,000 representing payments under operating leases was expensed (2009: $2,139,000).

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.

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

Common shares issued or reserved:

	Number of shares	Amount
December 31, 2008	32,314,929	62,269
Share issue (c)		
Cash	78,824,445	5,244
Non-cash	66,592,738	4,934
Issuance costs	-	(493)
	145,417,183	9,685
December 31, 2009	177,732,112	71,954
Share issue (b)		
Cash	17,773,211	977
Issuance costs	-	(4)
December 31, 2010	195,505,323	72,927

a) The Company has reserved a total of 1,141,512 common shares for issuance, the maximum number that may be exercised under the terms of the convertible debenture due on March 31, 2011 (note 14a).

b) On March 1, 2010, the Company completed a private placement of 17,773,211 common shares at $0.055 per share for gross proceeds of $977,000. Subscribers in the private placement were Panta Holdings B.V., which has subscribed for 15,995,890 common shares, and Working Opportunity Fund (EVCC) Ltd., which has subscribed for 1,777,321 common shares. The common shares issued under the private placement are subject to a restriction on resale for a period of four months and one day from the date of issue, in accordance with applicable Canadian securities laws.

   The costs of issuing capital stock during 2010 amounted to $4,000 and were deducted from gross proceeds to record $973,000 as capital stock.

c) During 2009, the Company issued 145,417,183 common shares from the following transactions:

   i) On July 21, 2009, the Company issued 16,157,465 common shares to Panta Holdings B.V. at $0.15 per share providing gross proceeds of $2,423,000. The Company received aggregate net proceeds of $858,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V.

   ii) On October 7, 2009, the Company completed a rights offering within which 129,259,718 common shares were issued at $0.06 per share providing gross proceeds of $7,755,000. The Company received aggregate net proceeds of $4,386,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V.

   The costs of issuing capital stock during 2009 amounted to $493,000 and were deducted from total proceeds of $10,178,000 to record $9,685,000 as capital stock.

d) The Company's incentive stock option plan is administered by the Board of Directors. At the 2010 Annual General Meeting, a Resolution was passed changing the Corporation's 2007 share option plan, from a fixed plan wherein 3,166,667 common shares are reserved for issuance, to a rolling share option plan wherein 10% of the issued and outstanding common shares at the time an option is granted be reserved for issuance.

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

A summary of the Company's stock option plan as of December 31, 2010 and December 31, 2009, and changes during the periods ending on those dates, is presented below.

	2010		2009	
	Options (000's)	Weighted Average Exercise Price	Options (000's)	Weighted Average Exercise Price
Outstanding - Beginning of year	-	$ -	60	$ 1.85
Granted	8,766	0.05	-	-
Forfeited	-	-	(60)	(1.85)
Exercised	-	-	-	-
Outstanding - End of year	8,766	0.05	-	-

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

	2010	2009
Beginning of year	$ 2,647	$ 2,647
Stock-based compensation expense	15	-
Transfer to capital stock on exercise of options and warrants	-	-
End of year	2,662	2,647

f) The Company has no warrants outstanding as at December 31, 2010 (December 31, 2009: 450,000). During the current year 450,000 warrants expired having a fair value of $71,000.

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. The costs of issuing the preferred shares during 2006 amounted to $546,000 and were deducted from the gross 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. Dividend payments have been deferred since January 2009. Unpaid dividends as at December 31, 2010 amounted to $1,512,000 (December 31, 2009: $756,000).

Each preferred share is convertible at any time, without the payment of additional consideration, at the option of the holder 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 are 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.

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.

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

Prior to December 31, 2008, holders of preferred shares converted 383,200 preferred shares resulting in 816,800 preferred shares remaining having a $8,168,000 gross book value, which net of issuance $546,000 costs results in a $7,622,000 net 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.

The fair value of 8,766,000 options granted during the year ended December 31, 2010 was $273,000. These options are exercisable at $0.05 each, with 2,922,000 options vesting on November 16, 2011, 2,922,000 options vesting on November 16, 2012 and 2,922,000 options vesting on November 16, 2013. All 8,766,000 options expire on November 15, 2015.

The assumptions used in the valuation of stock options were as follows:

	2010
Risk-free interest rate (%)	2.20
Dividend yield (%)	0
Expected lives (years)	5.0
Volatility (%)	75.40

The amount of stock-based compensation expense, for options granted in current and prior periods, amortized to earnings during the year ended December 31, 2010 was $15,000 (December 31, 2009: $Nil).

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.

	December 31, 2010	December 31, 2009
Defined contribution plan	$ 1,332	$ 1,241

The Company's contribution to the plan is calculated on a percentage of employee wages. The range of percentages is 1.5% to 9.5%. The plan is available to all employees.

20 Interest Expense and Financing Charges

	December 31, 2010	December 31, 2009
Interest on capital leases	$ 160	$ 236
Interest on other long-term debt	-	287
Interest on short-term debt	873	923
Interest on related party debt	274	293
Accretion of equity component of convertible loan	54	-
Net interest expense	1,361	1,739

(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:

	December 31, 2010	December 31, 2009
Accretion on convertible loan	$ 54	$ -
Accrued interest and government royalties	584	839
Amortization and depreciation	3,761	4,083
Deferred tooling revenue amortization	(834)	(1,018)
Development cost amortization	243	88
Foregone deposit on equipment purchase	-	231
Future income tax liability	(858)	(328)
Prepaid rent amortization	-	374
Provision for loss-making contracts	(202)	515
Provision for obsolete inventory	(457)	901
Unrealized derivative gains	(4)	722
Warranty provisions	334	(102)
Write-down of equipment	349	562
Write-down of intangible assets	1,482	-
Other items	(197)	(459)
	4,255	6,408

b) Changes in non-cash items:

	December 31, 2010	December 31, 2009
Accounts receivable	$ (1,714)	$ 6,574
Inventories	1,270	2,293
Prepayments	(830)	205
Warranty claim receivable	-	243
Accounts payable and accrued liabilities	2,108	(8,752)
Warranty provision	(177)	(54)
	657	509

c) Non-cash financing and investing activities:

	December 31, 2010	December 31, 2009
Assets acquired under capital leases	$ 6	$ 33
Equity component of convertible loan	453	-
Offset of accounts payable against warranty claim receivable	-	75
Uncollected deferred tooling revenue	466	652
Repayment of debt and interest via issue of common shares	-	4,934
Reversal of warranty provisions	1,776	-

22 Warranty Provisions

a) During 2010, the Company provisioned $417,000 of expect warranty expenditures relating to a manufacturing deficiency within its supply chain with a sub-contractor. All rectifications have not been completed by the date of this report, and $35,000 remains provisioned for expected future expenditures.

b) During 2010, the Company provisioned for $428,000 of expected warranty expenditures relating to a manufacturing deficiency. All rectifications have not been completed by the date of this report, and $132,000 remains provisioned for expected future expenditures.

c) A customer advised the Company that an expected repair of a product delivered in previous years did not require any further rework. Accordingly, the estimated warranty provision recorded in 2007 was reversed.

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

23 Income Taxes

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

	December 31, 2010	December 31, 2009
Combined basic income tax rate	28.5%	30.0%
Income tax (recovery) at the basic income tax rate	$ (2,412)	$ (2,523)
Adjustment of provision to tax return	(318)	(1,000)
Impact of change in statutory income tax rate	(306)	239
Share issue costs	0	(124)
Non-capital and capital losses expired	1,861	-
Change in valuation allowance	427	2,991
Other	(110)	89
Future income tax recovery	(858)	(328)

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:

	December 31, 2010	December 31, 2009
Future income tax assets (liability)		
Non-capital losses	$ 11,458	$ 5,729
Scientific research expenditures	2,541	2,229
Investment	382	382
Capital losses	0	623
Property, plant and equipment	2,406	5,554
Gain deferred for accounting purposes	284	1,112
Expenses not deductible in current period	807	1,722
Financing costs	233	284
Investment tax credits	2,261	1,945
Intangible asset	0	(492)
	20,372	19,088
Less: Valuation allowance	(20,372)	(19,946)
Net future income tax asset (liability)	0	(858)

c) The Company has available non-capital loss carry-forwards totalling approximately $45,831,000. These losses expire as follows:

Expiry Date	Loss Carry-Forwards
2013	$ 5,452
2014	8,416
2025	371
2026	2,781
2027	30
2028	4,308
2029	21,069
2030	3,404

d) The Company has approximately $10,163,000 of unclaimed research and development costs that may be claimed against future taxable income.

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

e) 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
2017	$ 1,603
2018	705
2021	364
2026	30
2027	206
2028	110

No net future tax benefit has been recognized in these financial statements with respect to these losses, unclaimed research and development costs and ITCs.

24 Related Party Transactions

a) The former Chairman of the Board and shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. As at October 7, 2009, the guarantee was reduced to $1,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company paid a fee of 20% per annum on the remaining $1,000,000 limited guarantee calculated on a daily basis. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2010 amounted to $200,000 (December 31, 2009: $300,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2010 are $Nil (December 31, 2009: $Nil). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $200,000 for the year ended December 31, 2010 (December 31, 2009: $200,000).

b) During the year ended December 31, 2010, consulting services were provided by certain directors. Fees paid to certain directors, or Companies with which they have beneficial ownership, during the year ended December 31, 2010 amounted to $80,000 (December 31, 2009: $85,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2010 are $2,000 (December 31, 2009: $10,000). These fees are included in the Statements of Operations as administrative and general expenses and amount to $72,000 for the year ended December 31, 2010 (December 31, 2009: $95,000).

Other related-party transactions are disclosed elsewhere in these financial statements (notes 14d and 16b).

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

25 Economic Dependence and Segmented Information

a) Sales to three major customers for the year ended December 31, 2010, which comprise several programs and contracts, accounted for approximately 88.6% (December 31, 2009: 81.8%) of sales.

	2010		2009	
	Revenue	% of Total	Revenue	% of Total
Boeing	$ 23,629	30.6	$ 23,493	33.9
Bombardier	19,997	25.9	17,681	25.6
Cessna	24,763	32.1	15,419	22.3
Other	8,869	11.4	12,609	18.2
Total	77,258	100.0	69,202	100.0

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

AVCORP INDUSTRIES INC.

Board of Directors and Officers

David Levi (1)(2)(3)
CHAIRMAN OF THE BOARD
President and CEO
GrowthWorks Capital Ltd.
Vancouver, British Columbia

Jaap Rosen Jacobson (2)
DIRECTOR
Mijdrecht, The Netherlands

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

Kees de Koning (3)
DIRECTOR
Nootdorp, The Netherlands

Elizabeth Otis (3*)
DIRECTOR
Seattle, Washington, USA

Ray Castelli
DIRECTOR
West Vancouver, BC

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

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

Amandeep Kaler
Vice President, Operations
Surrey, British Columbia

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

Josie Monterosso
Vice President, Supply Chain
White Rock, British Columbia

(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

DIRECTORY

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Vancouver, British Columbia

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Barristers & Solicitors
Vancouver, British Columbia

Registrar and Transfer Agent

CIBC Mellon Trust Company
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PricewaterhouseCoopers LLP
Chartered Accountants
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