AVCORP

annual report 2011

ABOUT AVCORP INDUSTRIES INC. Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including BAE Systems, Boeing, Bombardier, and Cessna. With more than 50 years of experience, over 500 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 28, 2012, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2011.

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

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, 2011.

THREE-YEAR RESULTS

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

For the year ended December 31	2011	2010	2009[2]
OPERATIONS			
Revenues	**$ 86,018**	$ 77,258	$ 69,202
EBITDA[1]	**3,847**	(1,617)	(2,500)
Operating income (loss) before tax	**(362)**	(4,893)	(5,501)
Net income (loss)	**(2,452)**	(7,402)[3]	(8,410)
Basic income (loss) per share	**(0.01)**	(0.04)[3]	(0.12)
Diluted income (loss) per share	**(0.01)**	(0.04)[3]	(0.12)
FINANCIAL POSITION			
Net capital expenditures	**1,224**	1,228	402
Total assets	**54,961**	45,680	48,026
Bank indebtedness and long-term debt	**13,532**	16,853	16,364
Shareholders' equity	**1,112**	2,478[3]	16,844
Net book value per share	**0.01**	0.01[3]	0.09
Ratio: debt/equity	**12.17**	6.80[3]	0.97
Ratio: current assets/current liabilities	**1.66**	0.80[3]	1.04
Shares outstanding at period end	**201,994,113**	195,505,323	177,732,112

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards (IFRS)
2. Prepared in accordance with Canadian Generally Accepted Accounting Principles (CGAAP)
3. As restated, from previously reported, for change in classification of preferred shares and dividends under IFRS

Quarterly Results

The following table provides selected unaudited quarterly financial information for the eight most recent fiscal quarters to December 31, 2011.

QUARTERLY RESULTS

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

	2011				2010			
For the three months ended	**Dec 31**	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	**$ 24,227**	$ 20,383	$ 20,492	$ 20,916	$ 19,364	$ 21,808	$ 18,710	$ 17,376
Operating (loss) profit	**1,093**	(186)	(752)	(517)	(938)	267	(2,191)	(2,031)
EBITDA[1,2]	**1,920**	1,455	259	213	(705)	1,129	(957)	(1,084)
Net income (loss)[4]	**293**	(150)	(1,337)	(1,258)	(2,191)	(374)	(2,402)	(2,435)
EBITDA per share[1,2]								
Basic	**0.01**	0.01	0.00	0.00	(0.00)	0.01	(0.00)	(0.01)
Diluted	**0.01**	0.01	0.00	0.00	(0.00)	0.01	(0.00)	(0.01)
Net income (loss) per share[4]								
Basic	**0.00**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)
Diluted	**0.00**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)
Long-term debt	**12,027**	12,555	6,516	3,129[3]	3,275[3]	3,866[3]	4,046[3]	2,380[3]

1. EBITDA = earnings before interest, taxes, depreciation and amortization
2. EBITDA is not a recognized term under IFRS
3. Exclusive of convertible debenture held by Export Development Canada classified as current portion of long-term debt
4. As restated, from previously reported, for change in classification of preferred shares and dividends under IFRS

During the course of the Company's 2011 year-end financial audit it was determined that, as a result of specific differences between the application of Canadian GAAP (EIC-70) and IFRS (IAS 32), the Company's preferred shares should have been classified as a liability on the January 1, 2010 IFRS transition date. Application of the presentation and measurement principles of IAS 32 – Financial Instruments is complex, particularly in evaluating instruments that have multiple characteristics such as these preferred shares.

The impact of this difference, applied on a comparative basis, for the first three quarters of 2011 has been disclosed in the financial statements for the year ended December 31, 2011. The preferred share reclassification results in a $7,622,000 reduction in equity with a corresponding increase in liabilities. This is first quantified in the January 1, 2010 opening IFRS transitional balance sheet. On a quarterly basis, commencing on March 31, 2010 through to December 31, 2011, the preferred share dividends accrued and charged to retained earnings are recorded as finance costs thereby reducing net income by $189,000 per quarter.

2011 and 2010 Results Overview

During the year ended December 31, 2011, the Company recorded a loss from operations of $362,000 on $86,018,000 revenue, as compared to a $4,893,000 operating loss on $77,258,000 revenue for the preceding year; and a net loss for the current year of $2,452,000 as compared to a net loss of $7,402,000 for the year ended December 31, 2010.

Current year revenues have increased by 11% from the immediately preceding year; a three year high for sales. Year-on-year the Company's revenues increased by $8,760,000, primarily from strong Boeing programs demand, start-up and commencement of production deliveries for BAE Systems (Operations) Limited (BAE) F35 program, as well as increased demand for non-original equipment manufacturer's products and services.

A combination of sales growth, improvements in both operating efficiencies and production quality levels, as well as continued stringent cost controls have reduced net losses by $4,950,000 in 2011 relative to 2010.

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $4,149,000 of overhead costs during the current year (December 31, 2010: $4,125,000) in respect of unutilized plant capacity. Further revenue growth would benefit Company profitability via a contribution to the recovery of fixed overhead expenditures.

The Company has decreased its provision for loss making contracts by $688,000 during the current year, due to improvements in certain program gross margins as well as reductions in the anticipated number of loss-making aircraft components to be delivered.

Cash flows from operating activities during the year ended December 31, 2011 utilized $1,520,000 of cash due to funding working capital growth in support of pending new program deliveries; as compared to utilizing $1,971,000 of cash during the year ended December 31, 2010. The Company has a working capital surplus of $14,663,000 as at December 31, 2011 (December 31, 2010: $6,275,000 deficit) arising from growth in accounts receivable and inventories as well as a replacement of current bank debt (operating line of credit) with long term debt; and an accumulated deficit of $76,016,000 at December 31, 2011 (December 31, 2010: $73,564,000).

The Company has operating lines of credit with a Canadian chartered bank which are available to provide up to $9,000,000 (December 31, 2010: $15,000,000) of financing; the current year end utilization is $Nil as compared to a utilization of $8,158,000 as at December 31, 2010. The facilities are due on demand. The banking agreement expires on April 1, 2012. The Company is currently in discussion with its bank to further extend the agreement. The Company has cash on hand as at December 31, 2011 amounting to $3,778,000.

In conjunction with the banking requirements, on May 24, 2011 the Company completed a term loan, provided by Panta III B.V. (Panta) through a wholly-owned subsidiary having a principal amount of $6,000,000, which funded on July 8, 2011.

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

The Company has deferred and therefore not paid $2,268,000 of preferred share dividends as at December 31, 2011 (December 31, 2010: $1,512,000). From July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, became redeemable at the option of the holder in whole.

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares or paying preferred share dividends.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. There is a material uncertainty whether the Company will be able to satisfy its obligations in the next 12 months through operations, leading to a significant doubt on the validity of the going concern assumption.

To mitigate this material uncertainty, management is actively working to secure additional production orders, has completed loan financing and renegotiated debt repayments, will continue to work with existing preference shareholders, and will seek additional financing as necessary. However, there can be no assurance that these initiatives will be successful.

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, 2011 was $86,018,000 as compared to $77,258,000 for the year ended December 31, 2010. Revenues have increased by approximately 11% relative to the year ended December 31, 2010 (2009 to 2011 year-on-year revenue growth in excess of $8,000,000 per year), primarily as a result of current year increased deliveries for Boeing programs, new program start-up, as well as increased demand for non-original equipment manufacturer's products and services.

Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

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

	2011		2010	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$ 3,666**	**4.2**	$ -	-
Boeing	**26,887**	**31.3**	23,629	30.6
Bombardier	**17,062**	**19.8**	19,997	25.9
Cessna	**25,883**	**30.1**	24,763	32.1
Other	**12,520**	**14.6**	8,869	11.4
Total	**86,018**	**100.0**	77,258	100.0

During the quarter end December 31, 2011, the Company delivered the first F-35 Carrier Variant Outboard Wing (CV-OBW) production unit intended for in-service operation. The CV-OBW is regarded as one of the most complex assemblies that the Canadian aerospace industry contributes to the F-35 program.

Avcorp secured the F-35 Outboard Wing contract in 2009, following a period of close collaboration with Industry Canada, BAE Systems and Lockheed Martin. Planning and rollout of manufacturing capabilities and quality systems occurred throughout 2010 with initial production beginning mid-2011.

Avcorp is currently the single source for this critical assembly. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35. It allows for easier handling and storage of the aircraft on the Carriers' deck and hangers, while keeping its long-range and low-landing speed flight characteristics. The Outboard Wing will be fitted onto the first production standard F-35 carrier version.

$3,666,000 of revenues generated by the F35 program in 2011 reflects production and non-recurring program introduction revenue streams.

Shipments of large assemblies to Boeing Commercial Airplane Group (Boeing CA), primarily for the 737 commercial jet program, slightly increased during the 2011 relative to 2010; while deliveries of fabricated parts increased significantly. The increased sales volume offset the negative impact on revenues arising from US dollar sales converted at an exchange rate which was less favourable in 2011 than in 2010. The Company also delivered 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 decreased during the current year relative to the year ended December 31, 2010 due to reduced deliveries for components of the Challenger CL605 and 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.

Revenues from Cessna Aircraft Company (Cessna) increased by approximately 5% during the year ended December 31, 2011, relative to 2010. The increase in deliveries from 2010 was primarily due to growth in Citation CJ4 business jet program deliveries which will continue through to the third quarter 2012. As with Boeing US dollar denominated sales, the strengthening of the Canadian dollar in 2011 relative to 2010 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. The Company and Cessna have announced that the current production work will be transitioned back to Cessna during 2011 and 2012; with two program deliveries being terminated in the third quarter 2011 and the majority remainder programs being terminated during the third quarter 2012. Discussions have not yet produced a definitive agreement with respect to the compensation and cost reimbursement in connection with the transition; a date for arbitration thereon has been set for the second quarter 2012.

Deliveries of Boeing 757 commercial jet 200 series wing adapter plugs for winglet retrofit to Aviation Partners Boeing increased significantly relative to the year ended December 31, 2010. This is as a result of a one-time resurgent demand for these aircraft retrofits by airlines.

Revenues for Comtek Advanced Structures Ltd. (Comtek) increased by 25% during 2011 relative to 2010, as revenues in all market segments increased due to customer demand.

Foreign exchange has adversely impacted consolidated revenues by 2% during the current year relative to 2010, 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, 2011 was 13.5% of revenue as compared to 8.9% of revenue for the year ended December 31, 2010.

Gross profit has significantly improved during 2011 relative to the previous year (2011: $11,652,000; 2010: $6,887,000) as increased revenues resulting from resurgent customer demand, as well as new program revenues, and increased operating efficiencies have had a positive impact on the Company's cost structure.

Year-on-year, fixed 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 2011. However, costs expensed as a result of idle plant capacity amounted to $4,149,000 during the current year (December 31, 2010: $4,125,000). The cost-revenue imbalance was partially mitigated in 2011 by new program revenue growth, which has occurred with full rate production for the Citation CJ4 business jet components; first delivery for the BAE Systems F35 program, as well as some increased customer demand for legacy programs.

The Company has decreased its provision for loss making contracts by $688,000 during the current year due to production efficiency improvements as well as a reduction in the anticipated number of loss-making aircraft components to be delivered (December 31, 2010: $202,000 decrease in provision for loss making programs).

New program revenue growth will be the largest contributing factor to 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 were reduced to 13.2% for the year ended December 31, 2011 from 14.0% for the year ended December 31, 2010. Year-on-year expenses increased by $542,000 primarily due to increased expenditures in support of new program introduction.

Foreign Exchange Gain or Loss

The Company recorded a $333,000 foreign exchange gain during 2011 (December 31, 2010: $43,000 loss) as a result of holding US dollar denominated receivables, payables and debt.

Earnings Before Interest, Taxes, Depreciation & Amortization

Earnings before interest, taxes, depreciation and amortization (EBITDA) was positive $3,847,000 for the year ended December 31, 2011 compared to a negative EBITDA of $1,617,000 for the year ended December 31, 2010. A $5,464,000 improvement largely contributed to by gross margin growth.

EBITDA

unaudited, expressed in thousands of Canadian dollars

	2011	2010
Income (loss) for the period	**$ (2,452)**	$ (7,402)
Interest expense and financing charges	**2,423**	2,117
Income tax expense	**-**	-
Depreciation	**3,494**	3,425
Amortization of development costs	**382**	243
	3,847	(1,617)

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, 2011 was $2,423,000 as compared to $2,117,000 for the same quarter in 2010. The increase in interest and financing charges for 2011 is primarily as a result of the replacement of lower cost demand debt with long term debt having a higher interest rate. Included within interest expense and financing charges for both fiscal years are $756,000 of preferred share dividends.

Income Taxes

The Company has not incurred a tax expense during the current year (December 31, 2010: $Nil).

Income or Loss

Loss for the year ended December 31, 2011 was $2,452,000 as compared to $7,402,000 loss for the year ended December 31, 2010. Continued improved gross profits in 2011 arising from increased revenues and improved operating efficiencies, as well as a foreign exchange gain were the underlying factors for the year's significantly reduced losses.

Liquidity and Capital Resources

The Company's operating lines of credit provide for a total utilization of $9,000,000. The Company ended the current year with bank operating line utilization of $Nil compared to utilization of $8,158,000 as at December 31, 2010. The Company completed a drawdown of the principal amount of $6,000,000 pursuant to its secured term loan agreement with Panta III B.V., a wholly-owned subsidiary of Panta Holdings B.V., on July 8, 2011. The proceeds were used specifically for the reduction of the Company's operating line of credit. The banking agreement expires on April 1, 2012. The Company is currently in discussion with its bank to further extend the agreement. The Company has cash on hand as at December 31, 2011 amounting to $3,778,000.

The Company has deferred and therefore not paid $2,268,000 of preferred share dividends which were accrued and payable as at December 31, 2011 (December 31, 2010: $1,512,000). From July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, became redeemable at the option of the holder in whole.

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. There is a material uncertainty whether the Company will be able to satisfy its obligations in the next 12 months through operations, leading to a significant doubt on the validity of the going concern assumption.

To mitigate this material uncertainty, management is actively working to secure additional production orders, has completed loan financing and renegotiated debt repayments, will continue to work with existing preference shareholders, and will seek additional financing as necessary.

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital provided $540,000 for the year ended December 31, 2011 compared to utilizing $2,628,000 during the previous year. The reduction in cash utilization in 2011 from 2010 is primarily attributable to a reduction of losses in 2011 over 2010.

Non-cash operating assets and liabilities utilized $2,060,000 of cash during the current year, compared to providing $657,000 of cash during 2010. This cash utilization increased primarily as a result of an increase in inventory levels due to 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 $1,224,000 as compared to $1,228,000 during the year ended December 31, 2010. The Company continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made. Expenditures incurred during 2011 were predominantly related to information technology infrastructure and plant equipment upgrades for new program start-up.

Additionally, the Company invested $741,000 during the current year (December 31, 2010: $1,501,000) in tooling and new program introduction, while $278,000 was expensed during the current year (December 31, 2010: $500,000) for new program introduction expenditures. Current year expenditures primarily 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, 2011, the Company's operating line of credit utilization decreased by $8,158,000 (December 31, 2010: $264,000 decreased utilization).

Interest paid during the current year on current and long-term debt amounted to $1,128,000 (December 31, 2010: $884,000).

For the year ended December 31, 2011, proceeds from funding of program introduction and working capital amounted to $11,412,000 (December 31, 2010: $4,057,000).

Also during the current year, the Company repaid $863,000 of equipment financing (December 31, 2010: $964,000).

On May 24, 2011, the Company issued a secured term loan with a principal amount of $6,000,000. The Company completed a drawdown of the principal amount of $6,000,000 pursuant to its secured term loan agreement with Panta III B.V., a wholly-owned subsidiary of Panta Holdings B.V., on July 8, 2011. The proceeds were used specifically for the reduction of the Company's operating line of credit.

On December 31, 2011, the ratio of the Company's current assets to current liabilities was 1.66:1 (December 31, 2010: 0.80:1), with the debt to equity ratio at 12.17:1 (December 31, 2010: 6.80:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	Total	2012	2013 – 2015	2016 – 2017	Post 2017
Convertible debenture	**$ 4,447**	$ 109	$ 1,500	$ 2,838	$ -
Capital lease obligation	**888**	664	224	-	-
Convertible loan	**2,303**	-	-	2,303	-
Term loan	**6,000**	-	-	6,000	-
Purchase obligation[1]	**16,825**	2,559	7,545	4,922	1,799
Other long-term obligations[2]	**1,088**	733	355	-	-
Total contractual obligations	**31,551**	4,065	9,624	16,063	1,799

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.

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's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due.

Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares.

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

Capital Stock

On August 15, 2011, the Company completed a private placement of 6,488,790 common shares for consideration of $324,000 representing accrued interest to June 30, 2011 on the Export Development Canada convertible debenture.

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.

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, 2011 amounted to $2,268,000 (December 31, 2010: $1,512,000).

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.

At any time after June 30, 2011, the preferred shares are redeemable in whole or in part at the option of the holder.

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares.

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 will be determined by the Company's directors at the time of creation of each series. There were 201,994,113 common shares issued and 21,688,720 reserved for issuance at December 31, 2011 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, 2011 was $77,128,000 (December 31, 2010: $76,042,000).

As at March 28, 2012, there were 201,994,113 common shares, 816,800 preference shares, and 8,766,000 stock options issued and outstanding.

New Accounting Policies

Convergence with International Financial Reporting Standards

The Company has adopted IFRS effective January 1, 2010. Prior to the adoption of IFRS the Company prepared its financial statements in accordance with Canada's previous Generally Accepted Accounting Principles for publicly accountable profit-oriented enterprises.

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 indicated that there was 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 was 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.

The standard setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies selected. The Company has processes in effect to ensure that potential IFRS accounting policy changes are monitored and evaluated. The impact of any new IFRS and IFRIC Interpretations will be evaluated as they are drafted and published.

Accounting Standards Issued But Not Yet Applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

IFRS 9 was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: Amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation–Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

IFRS 11 – Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities-Non-monetary Contributions by Venturers.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

IFRS 10, 11, 12 and 13 are effective for annual periods beginning on or after April 1, 2013, with early adoption permitted. The Company has yet to assess the impact of these new standards.

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, Separate Financial Statements (IAS 27), and IAS 28, Investments in Associates and Joint Ventures (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10-13.

The standard setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies selected. The Company has processes in effect to ensure that potential IFRS accounting policy changes are monitored and evaluated. The impact of any new IFRS and IFRIC Interpretations will be evaluated as they are drafted and published.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2011 were at planned levels for BAE Systems, Boeing, Bombardier and Cessna programs. The Company has achieved top quality and delivery ratings for the majority of its programs.

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 April 15, 2013. The Bombardier and Cessna agreements extend for the life of the individual aircraft 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, 2011, was $159 million, ($89 million of which pertains to 2012), compared to $251 million as at December 31, 2010. The changes in order backlog are as follows:

- $86 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2011;
- $55 million decrease in order backlog due to program transitions to Cessna; and
- $43 million increase in order backlog due to increases in the production rates of various existing programs; and
- $6 million increase in order backlog resulting from change 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 completion of the transition. Cessna has currently placed orders for portions of 2012. Discussions have not yet produced a definitive agreement with respect to compensation and cost reimbursement for the Company from Cessna in connection with the transition as contemplated under the general terms agreement with Cessna. Accordingly, a prescribed arbitration process has been commenced and set for the second quarter 2012.

Supply Chain

Supplier quality and delivery performance met targeted levels during the year; the Company continues to monitor supplier performance in all aspects of quality, delivery and price. The Company will continue to work closely with its 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 continues with the process of setting up a comprehensive supply chain for the Joint Strike Fighter F-35 military jet aircraft program.

Working Capital Utilization

Total current assets less total current liabilities were in a surplus position of $14,663,000 at December 31, 2011 and a deficit of $6,275,000 at December 31, 2010. The change in position during 2011 was primarily due to the increase in accounts receivable and inventory attributable to growth in revenues and new program introductions, as well as a reduction of bank indebtedness resulting from long term debt financing.

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, 2011 was 550 (December 31, 2010: 562). 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

Manufacturing equipment and 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;
- no agreement on extension of customer contracts;
- 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 favourable 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:

The Company has deferred and therefore not paid $2,268,000 of preferred share dividends which were accrued and payable as at December 31, 2011 (December 31, 2010: $1,512,000). On July 1, 2011, the Company's preferred shares having an $8,168,000 gross book value, and all accrued and unpaid dividends are redeemable at the option of the holder in whole.

Customer Contracts

The Company is exposed to the risk that existing customer fixed-term contracts are not renewed at expiration date. 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. Renewal and awarding of new Boeing contracts will be supported by a performance guarantee provided by a significant shareholder. BAE Systems (Operations) Limited (BAE) customer contracts extended to April 15, 2013. The Company is currently negotiating the renewal and extension of these contracts.

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 the transition is completed. Cessna has currently placed orders for the entire 2011 year and portions of 2012. Discussions have not yet produced a definitive agreement with respect to compensation and cost reimbursement for the Company from Cessna in connection with the transition as contemplated under the general terms agreement with Cessna. Accordingly, a prescribed arbitration process has been commenced and set for the second quarter 2012.

Procured Materials and Parts

Delivery of the First Article Inspection parts and components for the Joint Strike Fighter F-35 program successfully met the Companies internal target dates. The Company is working closely with its suppliers to ensure capacity and material availability to meet rate increases on a number of commercial and military programs in 2012.

In addition, affordability projects were initiated in the third quarter with customers' participation to ensure ongoing cost reductions within the supply chain.

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 indicated that the aerostructures markets for commercial aircraft and business jets would continue to grow in 2012. 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 2012 and into 2013.
- Recovery of air travel rates and reduced airline capacity will increase rates on the Boeing 737 and Airbus A320 late in 2011 and into 2012.
- The production of the Boeing 757 wing adapter plug for winglet retrofits is not expected to continue at the 2011 rate into 2012; as limited demand is expected for this product in 2012.
- Bombardier Challenger 850 and the Challenger 605 business jet aircraft production decreased slightly in 2011, but are expected to be at slightly increased levels for 2012.
- Cessna Citation Sovereign and CJ3 business jet rates decreased significantly in 2009 and sales in this market segment have now shown modest recovery in 2011 and into 2012. The introduction of the CJ4 is progressing as planned showing continuous growth.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exist 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 56% of the Company's cost of sales is related to labour and overhead and 44% 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 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 costs. 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. This will be mitigated by increased revenue and facility utilization.

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 2012, followed by BAE Systems, Bombardier and Cessna.

The Company forecasts its 2012 revenue levels to maintain the level of growth commenced in 2010 through 2011. With the exception of capital expenditures required for new programs, the Company's investment in new equipment will be maintained at 2011 levels.

On May 20, 2011 the Company and its bank entered into an agreement amending its existing banking arrangement which, providing no event of default occurs under the terms of this amendment, the bank shall refrain from demanding repayment of the operating line of credit until April 1, 2012.

The Company has deferred and therefore not paid $2,268,000 of preferred share dividends which were accrued and payable as at December 31, 2011 (December 31, 2010: $1,512,000). On July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, are redeemable at the option of the holder in whole.

The Company forecasts its financing requirements for 2012 to be met by the current availability of the operating line of credit. However, further debt and equity financing may be required.

Transactions with Related Parties

A shareholder guaranteed the indebtedness of the Company to the bank limited 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 $1,000,000 limited guarantee calculated on a daily basis. Fees paid to a shareholder during the year ended December 31, 2011 amounted to $126,000 (December 31, 2010: $200,000). Fees payable to the shareholder as at December 31, 2011 are $Nil (December 31, 2010: $Nil). These fees are included in the Statements of Income and Comprehensive Income as finance costs and amount to $126,000 for the year ended December 31, 2011 (December 31, 2010: $200,000). This guarantee has been released by the bank during the year ended December 31, 2011.

During the year ended December 31, 2011, 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, 2011 amounted to $80,000 (December 31, 2010: $80,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2011 are $Nil (December 31, 2010: $2,000). These fees are included in the Statements of Income and Comprehensive Income as administrative and general expenses and amount to $78,000 for the year ended December 31, 2011 (December 31, 2010: $72,000).

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.

The secured subordinated convertible loan has been provided by Panta Holdings B.V., a related party, 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.

On May 24, 2011, the Company completed a secured subordinated term loan with a principal amount of $6,000,000. The Company received full funding from the loan on July 8, 2011.

The secured subordinated term loan has been provided by Panta III B.V. (Panta), a related party, through a wholly-owned subsidiary. The loan, which is evidenced by a promissory note, has a five year term; 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. Interest will be calculated, compounded, and paid monthly. Prepayments in whole or in part of the loan are permitted at any time without penalty. As per the requirements of the Toronto Stock Exchange, exercise of the conversion right of the loan into 85,714,286 common shares at a conversion price of $0.07 per common share was subject to disinterested shareholder approval, which approval was sought at the 2011 annual meeting of shareholders on June 16, 2011. As the conversion feature of the loan was not approved by the Company's shareholders at its Annual Meeting, the interest rate under the loan is 15% per annum.

As partial consideration for the loan, the Company issued to Panta, 19,550,532 common share purchase warrants, each warrant exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share. The value of the warrants issued (note 19f) has been treated as a transaction cost and will be accreted over the loan term.

Fourth Quarter

The following summarizes financial results for the fourth quarter 2011.

Operating income for the fourth quarter of 2011 was $1,093,000 from $24,227,000 in revenues, as compared to operating losses of $938,000 from $19,364,000 in revenues for the quarter ended December 31, 2010. This is the highest quarterly operating income since the economic downfall in 2009. The major contributing cause to significantly improved operating income for the fourth quarter of 2011 was the highest quarterly revenue in three years and continued improved operating efficiencies as well as significant cost controls. Accordingly, EBITDA also significantly improved from negative $705,000 in the fourth quarter of 2010 to positive EBITDA of $1,920,000 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 International Financial Reporting Standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported revenues and expenses.

Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.

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, 2011 provision for anticipated losses was $189,000 (December 31, 2010: $878,000). The decrease in this provision from December 31, 2010 was primarily as a result of the curtailment of a loss-making program, improvements in certain other program gross margins as well as a reduction in associated 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 $5,540,000 (December 31, 2010: $5,181,000). 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 net of contracted customer repayments. 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

Measurement Uncertainty relating to critical accounting estimates:

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 $12,523,000 (December 31, 2010: $14,794,000). Reduction in market demand during 2009 for business jet 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, dependent 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 dependent 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 as well as contractually required payments by customers. 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, 2011, $5,540,000 (December 31, 2010: $5,181,000) 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. $3,007,000 of deferred tooling costs are not supported by customer advances.
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $4,149,000 of overhead costs during the current year (December 31, 2010: $4,125,000) in respect of unutilized plant capacity.

- Warranty provisions are provided for when an actual deficiency is identified and through working with the customer, and is estimated based on the expected cost per unit over the number of units affected. 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 $85,000 remains provisioned for expected future expenditures.

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 5%. The maximum operating line of credit availability is $9,000,000 of which $Nil is utilized as at December 31, 2011 (December 31, 2010: $8,158,000). 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, 2011, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2010: $82,000) 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 gain recorded in 2011 was $333,000 as compared to a $43,000 loss for the year ended December 31, 2010.

As at the December 31, 2011 and 2010 balance sheet dates, the Company had the following US dollar denominated balances:

	2011	2010
Bank cash position	**$ 4,598**	$ 5,674
Accounts receivable	**6,041**	4,856
Accounts payable net of prepayments	**2,664**	542
Long-term debt	**713**	1,294

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 $726,000 in net earnings for the year ended December 31, 2011 (December 31, 2010: $869,000 increase in net earnings) 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), BAE Systems (Operations) Limited (BAE) 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 81.7% (December 31, 2010: 80.9%) 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, 2011 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, 2011, 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 International Financial Reporting Standards (IFRS) 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 IFRS. 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** President and 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 statement of financial position as at December 31, 2011 and 2010 and January 1, 2010 and the consolidated statements of income and comprehensive income and changes in equity and cash flows for the years ended December 31, 2011 and 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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 Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audits 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, 2011 and 2010 and as at January 1, 2010 and their financial performance and their cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which describes 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 28, 2012

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(prepared in accordance with IFRS, expressed in thousands of Canadian dollars)

FOR THE PERIOD ENDED DECEMBER 31	December 31, 2011	December 31, 2010	January 1, 2010
ASSETS			
Current assets			
Cash	**$ 3,778**	$ -	$ -
Accounts receivable (note 9)	**12,160**	8,869	6,689
Inventories (note 10)	**19,418**	14,886	15,497
Prepayments and other assets	**1,396**	1,804	970
	36,752	25,559	23,156
Non-current assets			
Prepaid rent (note 16)	**146**	146	146
Development costs (note 11)	**5,540**	5,181	3,923
Property, plant and equipment (note 12)	**12,523**	14,794	17,346
Warranty claim receivable	**-**	-	1,637
Total assets	**54,961**	45,680	46,208
LIABILITIES AND EQUITY			
Current liabilities			
Bank indebtedness (note 13)	**-**	8,158	8,422
Accounts payable and accrued liabilities (note 14)	**10,694**	9,122	6,996
Current portion of long-term debt (note 17)	**1,505**	5,420	6,131
Preferred shares (note 6e and 20)	**9,890**	9,134	8,378
	22,089	31,834	29,927
Non-current liabilities			
Deferred gain (note 16)	**311**	358	405
Lease inducement (note 16)	**666**	764	863
Deferred program revenues (note 15)	**18,671**	6,804	3,116
Long-term debt (note 17)	**12,027**	3,275	1,811
Warranty provisions (note 25)	**85**	167	1,647
	53,849	43,202	37,769
Equity			
Capital stock (note 19)	**73,251**	72,927	71,954
Equity component of convertible loan (note 17d)	**453**	453	-
Contributed surplus (note 19e)	**3,424**	2,662	2,647
Deficit	**(76,016)**	(73,564)	(66,162)
	1,112	2,478	8,439
Total liabilities and equity	**54,961**	45,680	46,208

Nature of operations and going concern (note 1)
Critical accounting estimates and judgments (note 4)
Obligations and commitments under capital and operating leases (note 18)
Subsequent events (note 29)

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

Approved by the Board of Directors on March 28, 2012

David Levi
Chairman

Eric Kohn TD
Committee Chair,
Audit & Corporate Governance Committee

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(prepared in accordance with IFRS, expressed in thousands of Canadian dollars, except number of shares and per share amounts)

FOR THE PERIOD ENDED DECEMBER 31	2011	2010
Revenues	**$ 86,018**	$ 77,258
Cost of sales (note 5)	**74,366**	70,371
Gross profit	**11,652**	6,887
Administrative and general expenses	**11,384**	10,842
Office equipment depreciation	**644**	943
Other (gains) and losses – net	**(14)**	(5)
Operating Income (loss)	**(362)**	(4,893)
Foreign exchange (gain) loss (note 8a)	**(333)**	43
Finance costs (note 23)	**2,423**	2,117
Income (loss) before income tax and other items	**(2,452)**	(7,053)
Write-down of equipment	**-**	349
Income tax expense (note 26)	**-**	-
Loss and total comprehensive loss for the period	**(2,452)**	(7,402)
Earnings (loss) per share:		
Basic earnings (loss) per common share	**(0.01)**	(0.04)
Diluted earnings (loss) per common share	**(0.01)**	(0.04)
Basic weighted average number of shares outstanding (000's)	**197,959**	192,632
Diluted weighted average number of shares outstanding (000's)	**229,202**	245,534

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(prepared in accordance with IFRS, expressed in thousands of Canadian dollars)

FOR THE PERIOD ENDED DECEMBER 31	2011	2010
Cash flows from operating activities		
Profit (loss) before tax	**$ (2,452)**	$ (7,402)
Adjustment for items not affecting cash:		
Accretion on convertible loan	**85**	54
Preferred share dividends accrued	**756**	756
Accrued interest and government royalties	**1,583**	1,307
Amortization and depreciation	**3,494**	3,425
Deferred tooling revenue amortization and reclassification to revenue	**(2,421)**	(834)
Development cost amortization	**382**	243
Fair value of warrants amortization	**88**	-
Provision for loss-making contracts	**(689)**	(202)
Provision for obsolete inventory	**(226)**	(457)
Stock based compensation	**144**	15
Write-down of equipment	**-**	349
Other items	**(204)**	118
	540	(2,628)
Changes in non-cash working capital		
Accounts receivable	**(414)**	(1,714)
Inventories	**(3,617)**	1,270
Prepayments	**413**	(830)
Accounts payable and accrued liabilities	**1,558**	2,108
Warranty provision	**-**	(177)
Net cash from operating activities	**(1,520)**	(1,971)
Cash flows from investing activities		
Purchase of equipment	**(1,224)**	(1,228)
Proceeds from disposal of property, plant and equipment	**-**	11
Payments relating to development costs and tooling	**(741)**	(1,501)
Net cash from investing activities	**(1,965)**	(2,718)
Cash flows from financing activities		
(Decrease) increase in bank indebtedness	**(8,158)**	(264)
Payment of interest	**(1,128)**	(884)
Proceeds from customer funding of program introduction	**11,412**	4,057
Proceeds from current and long-term debt	**6,000**	1,771
Repayment of current and long-term debt	**(863)**	(964)
Issue of common shares	**-**	977
Share issue expense	**-**	(4)
Net cash from financing activities	**7,263**	4,689
Net increase (decrease) in cash	**3,778**	-
Cash - Beginning of period	**-**	-
Cash - End of period	**3,778**	-

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(prepared in accordance with IFRS, expressed in thousands of Canadian dollars, except number of shares)

	Share capital		Equity component convertible			
	Shares	Amount	loan	Contributed surplus	Deficit	Total equity
Balance January 1, 2010	177,732,112	$ 71,954	$ -	$ 2,647	$ (66,162)	$ 8,439
Issue of common shares	17,773,211	973	-	-	-	973
Equity component of convertible loan	-	-	453	-	-	453
Stock-based compensation expense	-	-	-	15	-	15
Loss for the period	-	-	-	-	(7,402)	(7,402)
Balance December 31, 2010	195,505,323	72,927	453	2,662	(73,564)	2,478
Balance December 31, 2010	195,505,323	72,927	453	2,662	(73,564)	2,478
Issue of common shares	6,488,790	324	-	-	-	324
Stock based compensation expense	-	-	-	145	-	145
Fair value of warrants issued	-	-	-	617	-	617
Loss for the period	-	-	-	-	(2,452)	(2,452)
Balance December 31, 2011	**201,994,113**	**73,251**	**453**	**3,424**	**(76,016)**	**1,112**

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

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, 2011, the Company recorded a net loss of $2,452,000 on $86,018,000 revenue, as compared to a net loss of $7,402,000 on $77,258,000 revenue for the year ended December 31, 2010, and incurred negative cash flow from operating activities for the year ending December 31, 2011 amounting to $1,520,000 (December 31, 2010: $1,971,000 negative). The Company has a working capital surplus of $14,663,000 as at December 31, 2011 (December 31, 2010: $6,275,000 deficit).

The Company has accrued $2,268,000 of preferred share dividends as at December 31, 2011 (December 31, 2010: $1,512,000). From July 1, 2011, the Company's preferred shares having a $8,168,000 gross book value, and all accrued and unpaid dividends, became redeemable at the option of the holder in whole (note 6e and 20).

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares or paying preferred share dividends.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. There is a material uncertainty whether the Company will be able to satisfy its obligations in the next 12 months through operations, leading to a significant doubt on the validity of the going concern assumption.

To mitigate this material uncertainty, management is actively working to secure additional production orders, has completed loan financing (note 17e) and renegotiated debt repayments (notes 17a), will continue to work with existing preference shareholders, and will seek additional financing as necessary. However, there can be no assurance that these initiatives will be successful.

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. Basis of preparation and adoption of International Financial Reporting Standards

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these comparative consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of financial statements, including IFRS 1 First Time Adoption of IFRS. Subject to certain transition elections disclosed in note 6, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 6 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010. The consolidated statements of income and comprehensive income present expenses by function.

Note 6 discloses IFRS information for the year ended December 31, 2010 that is material to an understanding of these consolidated financial statements. Note 30 discloses the impact on previously reported quarterly financial results of certain changes to those financial statements as a result of a reclassification under IFRS.

3. Summary of significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements are described below. These policies have been consistently applied to all periods presented, unless otherwise stated. The exemptions taken in applying IFRS for the first time are set out in note 6.

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value.

Basis of consolidation

The financial statements of the Company consolidate the accounts of Avcorp Industries Inc. and its subsidiary Comtek Advanced Structures Ltd (Comtek). All significant intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are those entities (including special purpose entities) which the Company controls by having the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether Avcorp Industries Inc. controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are de-consolidated from the date that control ceases.

Foreign currency translation

- Functional and presentation currency: Foreign currency items included in the financial statements of each consolidated entity in the Avcorp Industries Inc. group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. The functional currency of the Company's subsidiary, Comtek, is also determined to be Canadian dollars.
- Transactions and balances: Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of income.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

  Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of income. Gains and losses arising from changes in fair value are presented in the statement of income within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of trade receivables and cash and cash equivalents, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

  The Company transfers trade receivables under certain bank-sponsored revolving securitization programs. Because the Company retains substantially all the risks and rewards of ownership of the factored receivables, it continues to recognize the full carrying amount of these receivables and accounts for these transactions as collateralized borrowings.

- Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables, bank debt and long-term debt. Trade payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

  Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

- Derivative financial instruments: The Company uses derivative financial instruments to reduce its exposure to price risk associated with its revenues, and costs of certain procured items. All derivatives have been classified on the balance sheet within prepayments other assets, or other liabilities and are classified as current or non-current based on the contractual terms specific to the instrument. Gains and losses on re-measurement are included in other gains and losses.

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss, as follows:

- Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

- Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

Impairment of non-financial assets

Property, plant and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or "CGU"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The Company evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the first-in, first-out ("FIFO") method. The cost of finished goods and work-in-progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity) including applicable depreciation on property, plant and equipment and amortization of intangible assets. Net realizable value is the estimated selling price less applicable selling expenses.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

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

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

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property, plant and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of other gains and losses in the statement of income.

Employee benefits

- Post-employment benefit obligations: Employees of companies included in these consolidated financial statements have entitlements under Company pension plans which are defined contribution pension plans.

  The cost of defined contribution pension plans is charged to expense as the contributions become payable.

- Stock based compensation: The Company grants stock options to certain employees. Stock options vest over three years and all expire five years after grant date. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model.

Compensation expense is recognized over the tranche's vesting period based on the number of awards expected to vest, by increasing contributed surplus. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

- Termination benefits: The Company recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal, or providing benefits as a result of an offer made to encourage voluntary termination. Benefits falling due more than twelve months after the end of the reporting period are discounted to their present value.

Provisions

Provisions for restructuring costs, warranties and legal claims, where applicable, are recognized in other liabilities when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

Revenue

Revenue is recognized when it is probable that the economic benefits will flow to the Company and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. These criteria are generally met at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product, when contractually required, has been obtained.

Revenue is measured based on the price specified in the sales contract, net of discounts and estimated returns at the time of sale. Historical experience is used to estimate and provide for discounts and returns. The Company does not have any multiple element revenue arrangements.

Cost of sales

Cost of sales includes the cost of production, including materials, direct labour, overhead expenses as well as applicable depreciation and amortization.

Income tax

Income tax comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are presented as non-current.

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

Dividends

Dividends on common and preferred shares are recognized in the Company's financial statements in the period in which the dividends are approved by the Board of Directors of the Company.

Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. The Company's potentially dilutive common shares comprise stock options granted to employees, warrants and convertible loans.

Research and development costs

Research costs are expensed as incurred. Development costs, which are currently all tooling and new program introduction costs 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.

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. Transaction costs are deducted from the value of the loan and accreted over the loan term.

Leases

Leases are classified as finance or operating leases. A finance lease that transfers substantially all the benefits and risks incident to the ownership of property is classified as a lease. All other leases are accounted for as operating leases whereby lease payments are expensed on a straight-line basis. 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.

Accounting standards issued but not yet applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

IFRS 9 was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: Amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation–Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 11 – Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities-Non-monetary Contributions by Venturers.*

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

IFRS 10, 11, 12 and 13 are effective for annual periods beginning on or after April 1, 2015, with early adoption permitted. The Company has yet to assess the impact of these new standards.

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates* and *Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10-13.

The standard setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies selected. The Company has processes in effect to ensure that potential IFRS accounting policy changes are monitored and evaluated. The impact of any new IFRS and IFRIC Interpretations will be evaluated as they are drafted and published.

4. Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make estimates and judgements that affect the amounts which are reported in the consolidated financial statements during the reporting period. Estimates and other judgments are evaluated at each reporting date and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances.

- Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.
- Carrying value of long-lived assets: The Company holds property, plant and equipment, (note 12) on the balance sheet amounting to $12,523,000 (December 31, 2010: $14,794,000). Reduction in market demand during 2009 for business jet 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, dependent 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 dependent 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 as well as contractually required payments by customers. 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, 2011, $5,540,000 (December 31, 2010: $5,181,000) in unamortized deferred tooling costs (note 11), 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. $3,007,000 of deferred tooling costs are not supported by customer advances.
- 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, 2011 provision for anticipated losses was $189,000 (December 31, 2010: $878,000). The decrease in this provision from December 31, 2010 was primarily as a result of the curtailment of a loss-making program, improvements in certain other program gross margins as well as a reduction in associated anticipated number of aircraft components to be delivered.
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $4,149,000 of overhead costs during the current year (December 31, 2010: $4,125,000) in respect of unutilized plant capacity.
- Warranty provisions are provided for when an actual deficiency is identified, and through working with the customer it is estimated based on the expected cost per unit over the number of units affected. 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 $85,000 remains provisioned for expected future expenditures.

5. Expenses by nature

The consolidated statement of income presents expenses by function. Accordingly, amortization and depreciation is no longer presented as a separate line on the statement, but is included within cost of sales to the extent that it relates to manufacturing machinery and equipment, as well as leasehold improvements.

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

Expenses by nature:

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Raw materials, purchased parts and consumables	**$ 39,198**	$ 39,608
Salary, wages and benefits	**33,813**	30,018
Depreciation and amortization	**3,494**	3,425
Rent	**2,336**	1,960
Contract services and consulting	**1,564**	1,617
Legal and Audit fees	**1,225**	1,116
Utilities	**996**	1,010
Transportation	**917**	800
Office equipment rental/maintenance	**592**	658
Travel costs	**504**	450
Insurance	**448**	472
Royalties	**395**	202
Other expenses	**898**	1,164
	86,380	82,500

6. Transition to IFRS

The effect of the Company's transition to IFRS, described in note 2, is summarized in this note as follows:

- Transition elections
- Reconciliation of equity and total comprehensive income as previously reported under Canadian GAAP to IFRS
- Adjustments to the statements of financial position, income and comprehensive income, and cash flows

Note 30 discloses the impact on previously reported quarterly financial results of certain changes to those financial statements as a result of a reclassification under IFRS.

Transition elections

The Company has applied the following transition exceptions and exemptions to full retrospective application of IFRS:

Business Combinations

An exemption is available, and selected by the Company within IFRS 1 that allows an entity to carry forward its previous CGAAP accounting for business combinations prior to the transition date. The exemption is limited to allowing entities not to retrospectively adjust business combination accounting in prior periods, with the transition rules for specific balances are still applicable. Therefore, entities are still required to evaluate any assets and liabilities arising from such transactions that are still recognized on the balance sheet as at the transition date to determine whether any adjustments (de-recognition or re-measurement) would be required to comply with IFRS.

Share Based Payments

In general, IFRS 2 – Share-based payment is to be applied to all grants of shares, options or other equity instruments made after November 7, 2002. Similarly, IFRS 2 applies to all liabilities arising from share-based (unit-based) payment transactions that exist at the later of the date of transition to IFRS and January 1, 2005.

The exemption allows first-time adopters to not apply IFRS 2 to equity instruments that were granted prior to November 7, 2002. It also allows the first-time adopter to not apply IFRS 2 to equity instruments granted after November 7, 2002 that vested before transition to IFRS. Finally, it allows the first-time adopter to not apply IFRS 2 to liabilities settled before the transition date. Such exemptions were selected by the Company.

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

Arrangements Containing Leases

This exemption taken allows the Company to determine whether an arrangement contains a lease, based on the facts and circumstances at the transition date rather than at the lease inception date.

If an entity made the same determination of whether an arrangement contained a lease in accordance with previous CGAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the entity need not reassess that determination when it adopts IFRS. For an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, that determination would have to have given the same outcome as that resulting from applying IAS 17 Leases and IFRIC 4.

For such arrangements that were not evaluated under EIC 150, the entity may elect to consider whether the arrangement contains a lease based on the facts and circumstances existing at January 1, 2010.

Compound Financial Instruments

This exemption applies when a compound financial instrument is split into separate liability and equity components and the liability is no longer outstanding. That is, if the liability component is no longer outstanding, a first-time adopter does not have to retrospectively separate the liability from the equity component. This exemption was selected by the Company.

Borrowing Costs

This exemption taken allows the Company to adopt IAS 23 prospectively to projects for which the capitalization commencement date is after January 1, 2010.

Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS (restated as per note 30)

Equity	December 31, 2010	January 1, 2010
Equity as reported under Canadian GAAP	$ 9,923	$ 16,844
IFRS equity increase (decrease) adjustments:		
Intangible assets impairment (note 6a)	-	(1,818)
Warranty provision (note 6b)	177	177
Future income tax recovery (note 6c)	-	858
Preferred share reclassification (note 6e)	(7,622)	(7,622)
Equity as reported under IFRS	2,478	8,439

Total Comprehensive Income (loss)	December 31, 2010
As reported under Canadian GAAP	$ (7,606)
Increase (decrease) in net income for:	
Amortization of intangibles (note 6d)	336
Write-down of intangibles (note 6a)	1,482
Future income tax recovery (note 6c)	(858)
Preferred share dividends (note 6e)	(756)
	204
Increase (decrease) in other comprehensive income:	-
As reported under IFRS	(7,402)

a) Impairment: Avcorp experienced significant operating losses during 2009, and the book value of its assets as at December 31, 2009 exceeded the market capitalization of the Company's common shares, indicating potential impairment. Consequently, an impairment review was required. Under Canadian GAAP, no impairment was required resulting from the undiscounted cashflow test, which is not allowed under IFRS, and so a discounted test was performed.

   The equipment and intangible assets of the Company's cash generating units were compared to the greater of the value in use model, determined by a discounted cash flow, and the fair value less costs to sell model. A pre-tax discount rate was used to calculate value in use.

   The discounted cash flow value, using a 17% discount rate with cash flows based on projected production order values for a 5 year period corresponding to the average estimated remaining life of equipment and intangible assets, resulted in an estimated value which approximated the carrying value of the equipment for the Comtek Advanced Structures Ltd. cash generating unit, with intangible assets written down to $Nil as at January 1, 2010.

b) Warranty provision: a general provision for warranty expenditures in the amount of $177,000 is not recognized under IAS37 and accordingly was reversed because it cannot be determined whether the cash outflows are probable, and a reasonable estimate of the warranty provision cannot be made.

c) Future income tax liability: which arose on the Company's purchase of Comtek Advanced Structures Ltd. accounted for as a business combination due to the recognition of an accounting value for intangible assets where there is no corresponding tax basis, has been reversed as a result of the impairment of intangibles assets on transition.

d) Amortization of intangible assets: impairment of intangible assets recorded on transition, under IFRS, has resulted in the reversal of intangible asset amortization expense recorded under Canadian GAAP during 2010.

e) Preferred shares: On initial recognition of the preferred shares under Canadian GAAP the Company classified the preferred shares as equity as it was concluded that it was more probable they would be converted to common shares than redeemed for cash. On initial recognition under IFRS, the cash redeemable amount is recorded at its carrying amount as a liability and with dividends accrued or paid being charged to income as financing costs. As a result, the Company recorded (January 1, 2010) an initial preferred share liability of $8,378,000 comprised of $8,168,000 gross book value, $756,000 unpaid dividends and net of $546,000 issuance costs. As the redeemable amounts are demandable by the holders of the preference shares, they have been recorded in current liabilities. However, as the company is restricted from paying dividends on or redeeming preference shares by the Canadian Business Corporation Act as well as its lending agreements with its bank (note 13), debenture holder (note 17a) and term loan provider (note 17e), these amounts are not currently payable by the Company.

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

Adjustments to the statements of financial position, income and comprehensive income, and cash flows (restated as per note 30)

Statements of Financial Position	**December 31, 2010**			**January 1, 2010**		
	Canadian GAAP	**ADJ**	**IFRS**	**Canadian GAAP**	**ADJ**	**IFRS**
ASSETS						
Current assets	$ 25,559	$ -	$ 25,559	$ 23,156	$ -	$ 23,156
Non-current assets	20,121	-	20,121	23,052	-	23,052
Intangible assets (note 6a)	-	-	-	1,818	(1,818)	-
Total assets	45,680	-	45,680	48,026	(1,818)	46,208
LIABILITIES AND EQUITY						
Current liabilities	13,578	-	13,578	14,553	-	14,553
Accounts payable and accrued liabilities (note 6b and e)	10,811	(1,689)	9,122	7,929	(933)	6,996
Preferred shares (note 6e)	-	9,134	9,134	-	8,378	8,378
	24,389	7,445	31,834	22,482	7,445	29,927
Non-current liabilities	11,368	-	11,368	7,842	-	7,842
Future income tax liability (note 6c)	-	-	-	858	(858)	-
	35,757	7,445	43,202	31,182	6,587	37,769
Equity						
Attributable to shareholders of the Company						
Capital stock	72,927	-	72,927	71,954	-	71,954
Equity component of convertible loan	453	-	453	-	-	-
Preferred shares (note 6e)	7,622	(7,622)	-	7,622	(7,622)	-
Contributed surplus	2,662	-	2,662	2,647	-	2,647
Deficit (notes 6a,b,c, d and e)	(73,741)	177	(73,564)	(65,379)	(783)	(66,162)
	9,923	(7,445)	2,478	16,844	(8,405)	8,439
Total equity and liabilities	45,680	-	45,680	48,026	(1,818)	46,208

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

Statements of Income and Comprehensive Income	**Year ended December 31, 2010**		
	Canadian GAAP	**ADJ**	**IFRS**
Revenues	$ 77,258	$ -	$ 77,258
Cost of sales	70,371	-	70,371
Gross profit	6,887	-	6,887
Administrative and general expenses	10,842	-	10,842
Office equipment depreciation (note 6d)	1,279	(336)	943
Other (gains) and losses – net	(5)	-	(5)
Operating (loss) profit	(5,229)	(336)	(4,893)
Foreign exchange (gain) loss	43	-	43
Finance costs (note 6e)	1,361	756	2,117
Loss before income tax	(6,633)	420	(7,053)
Income taxes recovery (expense)	-	-	-
Future income tax recovery (expense) (note 6c)	858	(858)	-
Write-down of equipment	(349)	-	(349)
Write-down of intangible assets (note 6a)	(1,482)	1,482	-
Loss and comprehensive loss for the period	(7,606)	204	(7,402)
Earnings (loss) per share:			
Basic and diluted loss per common share	(0.04)	-	(0.04)

Statements of Cash Flows	**Year ended December 31, 2010**		
	Canadian GAAP	**ADJ**	**IFRS**
Cash flows from operating activities			
Profit (loss) before tax (notes 6a,c,d,e)	$ (7,606)	$ 204	$ (7,402)
Adjustment for items not affecting cash:			
Amortization and depreciation (note 6d)	3,761	(336)	3,425
Future income tax liability (note 6c)	(858)	858	-
Write-down of intangible assets (note 6a)	1,482	(1,482)	-
Preferred share dividend accrual (note 6e)	-	756	756
Other items	593	-	593
	(2,628)	-	(2,628)
Changes in non-cash working capital	657	-	657
Net cash from operating activities	(1,971)	-	(1,971)
Net cash from investing activities	(2,718)	-	(2,718)
Net cash from financing activities	4,689	-	4,689
Net increase/decrease in cash and cash equivalents	-	-	-
Cash and cash equivalents - Beginning of year	-	-	-
Cash and cash equivalents - End of year	-	-	-

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

7. 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 (note 17). The Company is subject to one capital restriction relating to redemption of preference shares (note 1). Other matters relating to capital risk management are set out in note 1.

8. 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 gain recorded in 2011 was $333,000 as compared to a $43,000 loss for the year ended December 31, 2010.

The Company had the following US dollar denominated balances:

	December 31, 2011	December 31, 2010	January 1, 2010
Bank cash position	**$ 4,598**	$ 5,674	$ -
Accounts receivable	**6,041**	4,856	4,028
Bank indebtedness	**-**	-	1,129
Accounts payable net of prepayments	**2,664**	542	829
Long-term debt	**713**	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 $726,000 in net earnings for the year ended December 31, 2011 (December 31, 2010: $869,000 increase in net earnings) as a result of holding a US dollar net asset position.

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), BAE Systems (Operations) Limited (BAE) and Cessna Aircraft Company (Cessna). During 2011 and 2010, there were no trade receivables written off by the Company in respect of these customers. The maximum exposure to credit risk is represented by the amount of accounts receivable in the balance sheet.

As at the balance sheet date 81.7% (December 31, 2010: 80.9%) of the Company's trade accounts receivable are attributable to these customers.

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

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. Other matters related to liquidity risk are set out in note 1.

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares.

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

The Company's operating line of credit is due on demand (note 13). Long-term debt repayments are as outlined in note 17. Preferred shares are redeemable as outlined in note 20.

The table below categorizes the Company's non-derivative financial liabilities into relevant maturity periods based on the remaining period from balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

				December 31, 2011
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness	$ -	$ -	$ -	$ -
Long-term debt	218	1,287	12,027	-
Preferred shares	9,890	-	-	-
Trade payables	6,515	-	-	-

				December 31, 2010
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness	$ -	$ 8,158	$ -	$ -
Long-term debt	4,771	649	3,275	-
Preferred shares	-	9,134	-	-
Trade payables	5,090	-	-	-

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 5%. The maximum operating line of credit availability is $9,000,000 (note 13) of which $Nil is utilized as at December 31, 2011 (December 31, 2010: $8,158,000). 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, 2011, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2010: $82,000) impact on net earnings and cash flow.

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

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

e) Price Risk

Certain of the Company's contracts contain derivative financial instruments to reduce 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, 2011, the Company has $27,251,000 (December 31, 2010: $24,196,000) of firmly committed orders that include price adjustment clauses of this nature. A $14,000 loss has been recorded as a derivative gain (loss) for the year ended December 31, 2011 as compared to a $7,000 gain for the year ended December 31, 2010 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, 2011, the Company has $239,000 (December 31, 2010: $324,000) of firmly committed purchases that include price adjustment clauses of this nature. A $Nil gain has been recorded in derivative income for the year ended December 31, 2011 as compared to a $2,000 loss for the year ended December 31, 2010 as a result of the change in the fair value of the underlying embedded derivatives.

Included in prepayments and other assets is $33,000 of inflation derivatives assets arising from the Company's sales and purchase contracts having price adjustment clauses within their terms (December 31, 2010: $28,000).

f) Financial Assets and Liabilities by Category

As at December 31, 2011 and 2010, the Company's financial assets and liabilities are categorized as follows:

				December 31, 2011
	Loans and receivables	**Held at fair value**	**Financial assets and liabilities at amortized cost**	**Total**
Financial Assets				
Accounts receivable	$ 12,160	$ -	$ -	$ 12,160
Commodity contracts	-	33	-	33
Financial Liabilities				
Accounts payable and accrued liabilities	-	-	10,694	10,694
Long-term debt	-	-	13,532	13,532
Preferred shares	-	-	9,890	9,890

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

				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
Currency and commodity contracts	-	28	-	28
Financial Liabilities				
Bank indebtedness	-	-	8,158	8,158
Accounts payable and accrued liabilities	-	-	9,122	9,122
Long-term debt	-	-	8,695	8,695
Preferred shares	-	-	9,134	9,134

				January 1, 2010
	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	-	-	6,996	6,996
Long-term debt	-	-	7,942	7,942
Preferred shares	-	-	8,378	8,378

g) Fair values

The fair values of the Company's accounts receivable, bank indebtedness, accounts payable and accrued liabilities and preferred shares are estimated to approximate their carrying values due to their immediate or short-term maturity. The Company's long term debt is held with Panta Holdings B.V. (“Panta”) (note 17d and 17e), which is a related party, and Export Development Canada (“EDC”) (note 17a), which is a governmental body, and management believes that any future debt would come from these or similar sources, due to the financial circumstances of the Company. The effective interest rates of 15% for the debt with Panta, and 5% for the EDC debt, are thought to approximate the rates that the Company could obtain if further debt was to be obtained. An increase of 1% in either the EDC debt or the Panta loans, representing a worsening of the credit position of the company in respect of these parties, would result in a change in the value of these loans by $101,000 and $140,000 respectively.

9. Accounts Receivable

	December 31, 2011	December 31, 2010	January 1, 2010
Trade receivables	**$ 11,249**	$ 8,110	$ 6,437
Input tax credits	**689**	710	146
Other receivables	**222**	49	106
	12,160	8,869	6,689

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

The carrying amounts of the Company's trade and other receivables are denominated in the following currencies:

	December 31, 2011	December 31, 2010	January 1, 2010
US dollar	**$ 6,041**	$ 4,872	$ 4,245
Canadian dollar	**6,017**	4,024	2,228

10. Inventories

	December 31, 2011	December 31, 2010	January 1, 2010
Raw Materials	**$ 8,571**	$ 6,458	$ 6,419
Work in progress	**10,293**	7,964	8,646
Finished products	**554**	464	432
	19,418	14,886	15,497

The amount of inventory expensed in cost of sales during the year ended December 31, 2011 amounted to $68,784,000. The carrying value of inventory pledged as security as at December 31, 2011 is $19,418,000.

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, 2011 provision for anticipated losses was $189,000 (December 31, 2010: $878,000). Work in progress inventory noted in the above table has been presented net of these provisions for anticipated losses.

11. Development Costs

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

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Opening balance	**$ 5,181**	$ 3,923
Additions	**741**	1,501
Amortization	**(382)**	(243)
	5,540	5,181

	December 31, 2011	December 31, 2010	January 1, 2010
Cost	**$ 6,619**	$ 5,878	$ 4,377
Accumulated amortization	**(1,079)**	(697)	(454)
Net book amount	**5,540**	5,181	3,923

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

12. Property, Plant and Equipment

	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
At January 1, 2010				
Cost	$ 35,704	$ 7,608	$ 985	$ 44,297
Accumulated depreciation	(20,832)	(5,655)	(464)	(26,951)
Net book amount	14,872	1,953	521	17,346
Year ended December 31, 2010				
Opening net book amount	14,872	1,953	521	17,346
Additions	520	618	96	1,234
Disposals – cost	(729)	-	-	(729)
Disposals – accumulated depreciation	368	-	-	368
Depreciation charge	(2,628)	(758)	(39)	(3,425)
Closing net book amount	12,403	1,813	578	14,794
At December 31, 2010				
Cost	36,243	8,226	1,081	45,550
Accumulated depreciation	(23,840)	(6,413)	(503)	(30,756)
Net book amount	12,403	1,813	578	14,794
Period ended December 31, 2011				
Opening net book amount	12,403	1,813	578	14,794
Additions	988	188	48	1,224
Disposals – cost	(1,045)	(380)	(248)	(1,673)
Disposals – accumulated depreciation	1,044	380	248	1,672
Depreciation charge	(2,818)	(599)	(77)	(3,494)
Closing net book amount	10,572	1,402	549	12,523
At December 31, 2011				
Cost	36,187	8,034	881	45,102
Accumulated depreciation	(25,615)	(6,631)	(333)	(32,579)
Net book amount	10,572	1,403	548	12,523

Included in computer hardware and software are assets held under finance leases at a cost of $149,000 (December 31, 2010: $1,395,000; January 1, 2010: $1,395,000) having accumulated depreciation of $149,000 (December 31, 2010: $1,225,000; January 1, 2010: $931,000).

Included in machinery and equipment are assets held under capital leases at a cost of $4,095,000 (December 31, 2010: $5,026,000; January 1, 2010: $5,006,000) having accumulated depreciation of $1,042,000 (December 31, 2010: $1,075,000; January 1, 2010: $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 $3,564,000 of costs incurred under development projects which were completed during previous years and subsequently reclassified from Development Costs (note 11) having a net book value of $618,000 as at December 31, 2011.

Included in leasehold improvements are assets held under finance leases at a cost of $52,000 (December 31, 2010: $52,000; January 1, 2010: $52,000) having accumulated depreciation of $21,000 (December 31, 2010: $16,000; January 1, 2010: $11,000).

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

During 2010 the value of certain equipment was written down by $349,000 (December 31, 2011: $Nil). 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 recoverable amount of other equipment amounted to a $63,000 charge against income.

13. Bank Indebtedness

The Company has operating lines of credit with a Canadian chartered bank totaling $9,000,000 (December 31, 2010: $15,000,000; January 1, 2010: $15,000,000) with utilization on December 31, 2011 at $Nil (December 31, 2010: $8,158,000; January 1, 2010: $8,422,000). The facilities are due on demand. The banking agreement expires on April 1, 2012. The Company is currently in discussions with its bank to further extend the agreement. The Company has cash on hand as at December 31, 2011 amounting to $3,778,000.

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;
- provided no event of default occurs under the terms of an agreement made on May 20, 2011, the bank shall refrain from demanding repayment of the operating line of credit until April 1, 2012;
- the shareholders of the Company will fund the difference between actual losses incurred and projected losses, within 30 days of any occurrence;
- the Company will not pay any dividends on its preferred shares or repurchase any of its preferred shares while the indebtedness to the bank remains outstanding (note 20);
- the Company must continue to defer all principal and interest payments on the Export Development Canada convertible debenture until April 1, 2012 (note 17a);
- interest at bank prime plus 5.0%; and
- the Company shall pay the bank a monthly fee of $10,000.

14. Accounts Payable and Accrued Liabilities

	December 31, 2011	December 31, 2010	January 1, 2010
Trade payables	**$ 6,515**	$ 5,090	$ 3,430
Payroll-related liabilities	**2,787**	2,408	2,540
Other	**1,392**	1,624	1,026
	10,694	9,122	6,996

15. Deferred Tooling Revenues

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Opening balance	**$ 6,804**	$ 3,116
Additions	**12,861**	4,522
Amortization	**(994)**	(834)
	18,671	6,804

(prepared in accordance with IFRS, 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.

16. Deferred Gain, Lease Inducement and Prepaid Rent

On July 17, 2003, the Company sold its land and building for gross proceeds of $16,000,000, representing $14,500,000 received in cash for the property and $1,500,000 as a lease inducement credit. Concurrently, the Company entered into a 15-year leaseback agreement with the purchaser of the property. A $712,000 gain arising on disposal of property in 2003 was recorded as a deferred gain and is being amortized to income over the life of the lease. The unamortized balance of the gain is $311,000 as at December 31, 2011 (December 31, 2010: $358,000; January 1, 2010: $405,000). The amount of prepaid rent the Company has as at December 31, 2011 is $146,000 (December 31, 2010: $146,000; January 1, 2010: $146,000).

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 $666,000 as at December 31, 2011 (December 31, 2010: $764,000).

17. Long-Term Debt

	December 31, 2011	December 31, 2010	January 1, 2010
Convertible debenture (a)	**$ 4,447**	$ 4,554	$ 4,338
Capital leases (b)	**888**	1,738	2,689
Accrued government royalties (c)	**1,088**	957	915
Convertible loan (d)	**1,638**	1,446	-
Term loan (e)	**5,471**	-	-
	13,532	8,695	7,942
Less: Current portion	**(1,505)**	(5,420)	(6,131)
	12,027	3,275	1,811

a) Export Development Canada Convertible Debenture

The Company entered into a First Amendment Waiver and Consent Agreement dated June 27, 2011 with Export Development Canada (EDC). Pursuant to this amendment, the terms of the debenture dated December 31, 2009 have been amended such that the debenture now has a maturity date of March 31, 2016.

The principal outstanding debenture amount of $4,338,000 is convertible at the option of the holder into 21,688,720 shares at a conversion price of $0.20. 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 and such weighted average trading price exceeds $4.00.

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

EDC agreed to accept 6,488,790 common shares of the Company in lieu of and in full and complete discharge of $324,000 accrued interest on the debenture to June 30, 2011 (note 19b).

Beginning July 1, 2011 until June 30, 2012, the interest due on the EDC debenture shall be payable in cash or common shares of the Company, at the election of the Company, at the 5-day volume weighted average trading price of the Company's common shares calculated retroactively from the final day of the fiscal quarter.

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

The conversion price reduction, the interest conversion and the debenture conversion do not require shareholder approval, but are subject to Toronto Stock Exchange approval, which the Company has received.

On July 27, 2011, the Company entered into a Second Amendment Agreement with Export Development Canada. Pursuant to this amendment the terms of the debenture dated December 31, 2009 have been amended such that beginning on July 1, 2011 until June 30, 2012 interest shall, at the election of the Company, be payable in cash or common shares of the Company at the end of each fiscal quarter. All interest thereafter is payable in cash.

Interest accrued and payable as at December 31, 2011 amounted to $109,000 (note 29).

b) Finance Leases

There are various equipment leases that have a weighted average interest rate of 6.94% 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. $725,000 of the leases are held in US dollars having a Canadian dollar equivalent of $888,000.

c) Accrued Government Royalties

Royalties of $1,088,000 (December 31, 2010: $957,000; January 1, 2010: $915,000) applicable on certain contracts 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.

The secured subordinated convertible loan has been provided by Panta Holdings B.V., a related party, 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.

Finance costs on the convertible loan are composed of the interest calculated on the face value of the convertible loan which amounted to $107,000 for the year ended December 31, 2011, and an annual notional interest representing the accretion of the carrying value of the convertible loan which amounted to $85,000.

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Principle amount of convertible loan	**$ 1,771**	$ 1,771
Accrued interest	**181**	74
Less equity component of convertible loan	**(453)**	(453)
Accreted interest	**139**	54
Liability component	**1,638**	1,446

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

e) Term Loan

On May 24, 2011, the Company completed a secured subordinated term loan with a principal amount of $6,000,000. The Company received full funding from the loan on July 8, 2011.

The secured subordinated term loan has been provided by Panta III B.V. (Panta), a related party, through a wholly-owned subsidiary. The loan, which is evidenced by a promissory note, has a five year term; 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. Interest will be calculated, compounded, and paid monthly. Prepayments in whole or in part of the loan are permitted at any time without penalty. As per the requirements of the Toronto Stock Exchange, exercise of the conversion right of the loan into 85,714,286 common shares at a conversion price of $0.07 per common share was subject to disinterested shareholder approval, which approval was sought at the 2011 annual meeting of shareholders on June 16, 2011. As the conversion feature of the loan was not approved by the Company's shareholders at its Annual Meeting, the interest rate under the loan is 15% per annum.

As partial consideration for the loan, the Company issued to Panta, 19,550,532 common share purchase warrants, each warrant exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share. The value of the warrants issued (note 19f) has been treated as a transaction cost and will be accreted over the loan term.

The Company remains subject to the following material covenants under the terms of the loan:

- while the loan or any obligations in respect thereof are outstanding, the Company shall not pay any dividends or distributions on its preferred shares nor will it repurchase any of its preferred shares; and
- the Company shall use its best efforts to negotiate and enter into, as soon as reasonable practicable, agreements with the holders of the preferred shares of the Company pursuant to which each such holder will (i) agree to postpone the exercise of the redemption rights on its preferred shares in the capital of the company and any payment which the Company would otherwise be required to make in connection therewith, together with the payment of all dividends on such preferred shares, until at least January 1, 2015 on terms and conditions acceptable to the lender or (ii) otherwise agree to such amendments to the terms of its preferred shares or other arrangements in respect thereof as are acceptable to the lender.

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Principle amount of convertible loan	**$ 6,000**	$ -
Accrued interest	**-**	-
Less fair value of warrants issued	**(617)**	-
Accretion of fair value of warrants issued	**88**	-
Liability component	**5,471**	-

18. Obligations and Commitments Under Finance 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:

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

FOR THE YEAR ENDED DECEMBER 31	2011		2010	
	Operating	**Finance**	Operating	Finance
2011	**$ -**	**$ -**	$ 2,561	$ 961
2012	**2,558**	**699**	2,573	686
2013	**2,553**	**228**	2,568	224
2014	**2,546**	**-**	2,566	-
2015	**2,447**	**-**	2,584	-
2016	**2,461**	**-**	2,599	-
Thereafter	**4,260**	**-**	4,466	-
Total future minimum lease payments	**16,825**	**927**	19,917	1,871
Less: Imputed interest	**n/a**	**(39)**	n/a	(133)
Balance of obligation under finance leases included in long-term debt (note 17b)	**-**	**888**	-	1,738

For the year ended December 31, 2011, an amount of $2,466,000 representing payments under operating leases was expensed (2010: $2,074,000).

19. Capital Stock

Authorized

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

Common shares issued or reserved:

	Number of shares	Amount
January 1, 2010	177,732,112	71,954
Share issue (c)		
Cash	17,773,211	977
Issuance costs	-	(4)
December 31, 2010	195,505,323	72,927
Share issue (b)		
Non-cash	6,488,790	324
December 31, 2011	201,994,113	73,251

a) The Company has reserved a total of 21,688,720 common shares for issuance, the maximum number that may be exercised under the terms of the convertible debenture due on March 31, 2011 (note 17a), as well as 29,516,666 common shares under the provision of a convertible loan (note 17d).

b) On August 15, 2011, the Company completed a private placement of 6,488,790 common shares in consideration of $324,000 interest accrued to June 30, 2011 on the Export Development Canada convertible debenture (notes 17a).

c) 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 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 were 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.

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

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.

A summary of the Company's stock option plan as of December 31, 2011 and December 31, 2010, and changes during the periods ending on those dates, is presented below.

FOR THE YEAR ENDED DECEMBER 31	**2011**		2010	
	Options (000's)	**Weighted Average Exercise Price**	Options (000's)	Weighted Average Exercise Price
Outstanding - Beginning of year	**8,766**	**$ 0.05**	-	$ -
Granted	**-**	**-**	8,766	0.05
Forfeited	**730**	**0.05**	-	-
Exercised	**-**	**-**	-	-
Outstanding - End of year	**8,036**	**0.05**	8,766	0.05

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

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Beginning of year	**$ 2,662**	$ 2,647
Stock-based compensation expense	**145**	15
Fair value of warrants	**617**	-
End of year	**3,424**	2,662

f) During the current year 19,550,532 warrants were issued having a fair value of $617,000 (note 17e). The Company had no warrants outstanding as at December 31, 2010.

20. 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, 2011 amounted to $2,268,000 (December 31, 2010: $1,512,000; January 1, 2010: $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.

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.

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

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA"). Under the CBCA, the Company may not purchase or otherwise acquire its own shares, including redeeming the preferred shares, if there are reasonable grounds for believing that the Company would after the purchase be unable to pay its liabilities as they become due. The Company's board has determined that honouring any redemption request for preferred shares, regardless of the number of shares involved, would result in the Company being unable to pay its liabilities as they become due.

While the Company currently is able to meet its existing obligation, it is reliant on certain credit and loan facilities for the normal, ongoing operation of its business. Those operating facilities currently provide that it is an event of default if the Company redeems any of its preferred shares. The inability of the Company to access its customary operating facilities would impair the proper operation of the Company's business and prohibit it from meeting, in the normal course, its liabilities as they become due. Accordingly, at this time the Company is prohibited from completing any redemption of preferred shares.

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.

21. 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. 730,000 options were forfeited during 2011. The remaining options are exercisable at $0.05 each, with 2,678,500 options vesting on November 16, 2011, 2,678,500 options vesting on November 16, 2012 and 2,678,500 options vesting on November 16, 2013. All 8,035,500 options expire on November 15, 2015.

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

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, 2011 was $144,000 (2010: $15,000).

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

22. Defined Contribution Plan

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

FOR THE YEAR ENDED DECEMBER 31	**2011**	2010
Defined contribution plan	**$ 1,411**	$ 1,332

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.

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

23. Finance Costs

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Interest on capital leases	**$ 95**	$ 160
Interest on other long-term debt	**348**	349
Interest on short-term debt	**473**	524
Interest on related party debt	**578**	274
Preferred share dividends accrued	**756**	756
Accretion of equity component of convertible loan	**85**	54
Accretion of fair value of warrants	**88**	-
	2,423	2,117

24. Supplementary Cash Flow Information

Non-cash financing and investing activities:

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Debt and interest paid using common shares	**$ 324**	$ -
Equity component of convertible loan	**-**	453
Fair value of warrants issued	**617**	-
Reversal of warranty provisions	**-**	1,776
Uncollected deferred tooling revenue	**2,876**	466

25. Warranty Provisions

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Opening balance	**$ 167**	$ 1,647
Charge/(credited) to the income statement:		
Additions	**-**	911
Increases(decreases) to existing provisions	**(54)**	(2,354)
Accretion	**-**	140
Used during year	**(28)**	(177)
	85	167

a) During 2010, the Company provided 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 $85,000 remains provisioned for expected future expenditures.

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

26. Income Taxes

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

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Statutory tax rate	**26.5%**	28.5%
Income tax (recovery) at the statutory income tax rate	**$ (650)**	$ (2,109)
Adjustment of provision to tax return	**121**	(318)
Difference between current and future tax rates	**48**	(306)
Non-capital losses expired	**-**	1,861
Change in unrecognized deferred tax assets	**178**	767
Non-deductible preferred share dividends	**200**	215
Other	**102**	(110)
Tax expense	**-**	-

The provision for income taxes recovery/expense is based on the combined federal and provincial annual income tax rate expected for the full financial year of 26.5%. The tax rate has decreased by 2% from December 31, 2010 due to a federal corporate tax rate reduction.

Deferred tax assets are recognized for deductible temporary differences, unused tax losses, and unused tax credits to the extent that the realization of the related tax benefit through future taxable profits is probable. The Company did not recognize deferred income tax assets of $20,551,000 (2010: $20,372,000) in respect of losses amounting to $45,150,000 (2010: $45,831,000) which expire beginning in 2013 through 2031, unclaimed research and development costs of $10,319,000 (2010: $10,163,000) with no expiry, and investment tax credits of $3,057,000 (2010: $3,018,000) which expire beginning in 2017 through 2030, and deductible temporary differences of $17,564,000 (2010: $16,329,000).

27. Related Party Transactions

a) A shareholder guaranteed the indebtedness of the Company to the bank limited 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 $1,000,000 limited guarantee calculated on a daily basis. Fees paid to a shareholder during the year ended December 31, 2011 amounted to $126,000 (December 31, 2010: $200,000). Fees payable to the shareholder as at December 31, 2011 are $Nil (December 31, 2010: $Nil; January 1, 2010: $Nil). These fees are included in the Statements of Income and Comprehensive Income as finance costs and amount to $126,000 for the year ended December 31, 2011 (December 31, 2010: $200,000). This guarantee has been released by the bank during the year ended December 31, 2011.

b) During the year ended December 31, 2011, 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, 2011 amounted to $80,000 (December 31, 2010: $80,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2011 are $Nil (December 31, 2010: $2,000; January 1, 2010: $10,000). These fees are included in the Statements of Income and Comprehensive Income as administrative and general expenses and amount to $78,000 for the year ended December 31, 2011 (December 31, 2010: $72,000).

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

c) Key management compensation

Key management includes Executive Officers for all operating facilities. The compensation paid or payable to key management for employee services is shown below.

FOR THE YEAR ENDED DECEMBER 31	2011	2010
Salaries and other short-term employee benefits	$ 642	$ 1,013
Contributions to defined contribution plan	34	48
Option-based awards	26	4
	702	1,065

d) Loans to related parties

The balance of loans receivable from key management of the Company as at December 31, 2010 was $47,000 (January 1, 2010: $47,000). During the year key management repaid $32,000 of the loans. The balance of loans receivable from key management as at December 31, 2011 is $15,000.

Other related-party transactions are disclosed elsewhere in these financial statements (notes 17d and 17e).

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

28. Economic Dependence and Segmented Information

a) Sales to four major customers for the year ended December 31, 2011, which comprise several programs and contracts, accounted for approximately 85.4% (December 31, 2010: 88.6%) of sales.

FOR THE YEAR ENDED DECEMBER 31	2011		2010	
	Revenue	% of Total	Revenue	% of Total
BAE Systems	$ 3,666	4.2	$ -	-
Boeing	26,887	31.3	23,629	30.6
Bombardier	17,062	19.8	19,997	25.9
Cessna	25,883	30.1	24,763	32.1
Other	12,520	14.6	8,869	11.4
Total	86,018	100.0	77,258	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. The Company operates from two locations in Canada.

Comtek Advanced Structures Ltd. a wholly owned subsidiary is located in Ontario and is dedicated to composites manufacturing. Avcorp Industries Inc. is located in British Columbia and is dedicated to light weight metal manufacturing and assembly. Revenues, profits and total assets are distributed by operating segment as noted in the tables below.

FOR THE YEAR ENDED DECEMBER 31	2011		2010	
	Revenue	% of Total	Revenue	% of Total
Avcorp Industries Inc.	$ 74,236	86.3	$ 67,857	87.8
Comtek Advanced Structures Ltd.	11,782	13.7	9,401	12.2
Total	86,018	100.0	77,258	100.0

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

FOR THE YEAR ENDED DECEMBER 31	**2011**		2010	
	Profit (loss)	**% of Total**	Profit (loss)	% of Total
Avcorp Industries Inc.	**$ (2,004)**	**81.7**	$ (6,701)	90.5
Comtek Advanced Structures Ltd.	**(448)**	**18.3**	(701)	9.5
Total	**(2,452)**	**100.0**	(7,402)	100.0

FOR THE YEAR ENDED DECEMBER 31	**2011**		2010	
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$ 51,247**	**93.2**	$ 41,839	91.6
Comtek Advanced Structures Ltd.	**3,714**	**6.8**	3,841	8.4
Total	**54,961**	**100.0**	45,680	100.0

29. Subsequent Events

Interest accrued and payable to Export Development Canada as at December 31, 2011 amounting to $109,000 was paid by common shares of the Company:

- 1,173,126 common shares on January 10, 2012.
- 1,150,395 common shares on February 6, 2012.

30. Prior Periods Financial Restatements (unaudited)

During the course of the Company's 2011 year-end financial audit it was determined that, as a result of specific differences between the application of Canadian GAAP (EIC-70) and IFRS (IAS 32), the Company's preferred shares should have been classified as a liability on the January 1, 2010 IFRS transition date (note 6e), with dividends accrued subsequent to January 1, 2010 recorded and classified as a financing cost. Application of the presentation and measurement principles of IAS 32 – Financial Instruments is complex, particularly in evaluating instruments that have multiple characteristics such as these preferred shares. The impact of this difference as at January 1, 2010 and for the first three quarters of 2011 (presented on a comparative basis) is as follows:

- Preferred shares in the amount of $7,622,000 previously recorded as equity is recorded as a separate line item "Preferred shares" in current liabilities.
- Preferred share dividends previously classified in other current liabilities is reclassified to "Preferred shares" in current liabilities
- A dividend accrued on preferred shares previously charged to retained earnings is recorded as "Finance costs" in the statement of income and comprehensive income.

The foregoing changes had no impact on operating, investing or financing cash flows for the periods presented.

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

Financial Position

	March 31, 2011		June 30, 2011		September 30, 2011	
	as previously reported	as restated	as previously reported	as restated	as previously reported	as restated
Current liabilities	$ 24,963	$ 23,262	$ 21,338	$ 19,448	$ 13,937	$ 11,858
Preferred shares (note 6e)	-	9,323	-	9,512	-	9,701
	24,963	32,585	21,338	28,960	13,937	21,559
Preferred shares (note 6e)	7,622	-	7,622	-	7,622	-
Other equity	1,268	1,268	(24)	(24)	217	217
	8,890	1,268	7,598	(24)	7,839	217

	January 1, 2010		December 31, 2010	
	as previously reported	as restated	as previously reported	as restated
Current liabilities	$ 22,305	$ 21,549	$ 24,212	$ 22,700
Preferred shares (note 6e)	-	8,378	-	9,134
	22,305	29,927	24,212	31,834
Preferred shares (note 6e)	7,622	-	7,622	-
Other equity	8,439	8,439	2,478	2,478
	16,061	8,439	10,100	2,478

Net Income (loss)

FOR THE QUARTER ENDED	March 31, 2011		June 30, 2011		September 30, 2011	
	as previously reported	as restated	as previously reported	as restated	as previously reported	as restated
Income (loss) before finance costs	$ (721)	$ (721)	$ (683)	$ (683)	$ 520	$ 520
Finance costs	(348)	(537)	(465)	(654)	(481)	(670)
Net income (loss) for the period	(1,069)	(1,258)	(1,148)	(1,337)	39	(150)

FOR THE PERIOD	six months ended June 30, 2011		nine months ended September 30, 2011	
	as previously reported	as restated	as previously reported	as restated
Income (loss) before finance costs	$ (1,404)	$ (1,404)	$ (884)	$ (884)
Finance costs	(813)	(1,191)	(1,294)	(1,861)
Net income (loss) for the period	(2,217)	(2,595)	(2,178)	(2,745)

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

FOR THE QUARTER ENDED	March 31, 2010		June 30, 2010		September 30, 2010	
	as previously reported	as restated	as previously reported	as restated	as previously reported	as restated
Income (loss) before finance costs	$ (1,989)	$ (1,989)	$ (1,906)	$ (1,906)	$ 163	$ 163
Finance costs	(257)	(446)	(307)	(496)	(348)	(537)
Net income (loss) for the period	(2,246)	(2,435)	(2,213)	(2,402)	(185)	(374)

FOR THE PERIOD	six months ended June 30, 2010		nine months ended September 30, 2010	
	as previously reported	as restated	as previously reported	as restated
Income (loss) before finance costs	$ (3,895)	$ (3,895)	$ (3,732)	$ (3,732)
Finance costs	(564)	(942)	(912)	(1,479)
Net income (loss) for the period	(4,459)	(4,837)	(4,644)	(5,211)

AVCORP INDUSTRIES INC.

BOARD OF DIRECTORS AND OFFICERS

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CHAIRMAN OF THE BOARD
President and CEO
GrowthWorks Capital Ltd.
Vancouver, British Columbia

Jaap Rosen Jacobson (2)
DIRECTOR
President
Panta Holdings B.V.
Mijdrecht, The Netherlands

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

Ray Castelli (1)
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Chief Executive Officer
Weatherhaven
West Vancouver, BC

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Nootdorp, The Netherlands

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

Jeff Schoenfeld
Vice President, Engineering and Development
Vancouver, 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

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Registrar and Transfer Agent

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Vancouver, British Columbia

Bank

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Vancouver, British Columbia

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