AVCORP

annual report 2013

ABOUT AVCORP INDUSTRIES INC. Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including BAE Systems, Boeing and Bombardier. With more than 50 years of experience, over 400 skilled employees and 354,000 square feet of facilities in Delta BC and Burlington ON, 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. Our Burlington location also offers composite repairs for commercial aircraft. Avcorp is a Canadian public company traded on the Toronto Stock Exchange (TSX:AVP).

management discussion & analysis

This Management Discussion and Analysis has been prepared as of March 31, 2014, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2013.

Description of Business

Avcorp Industries Inc. (the "Company" or "Avcorp") 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. ("Comtek"), a wholly owned subsidiary, is located in Ontario and is dedicated to composites manufacturing and repair. 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, 2013.

THREE-YEAR RESULTS

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

FOR THE YEAR ENDED DECEMBER 31	2013	2012[2]	2011[2]
OPERATIONS			
Revenues	**$ 77,364**	$ 89,337	$ 86,018
EBITDA[1]	**3,241**	29,035	3,847
Operating (loss) income before tax	**(2,015)**	24,002	(362)
Net (loss) income	**(1,802)**	20,641	(2,452)
Basic (loss) income per share	**(0.01)**	0.09	(0.01)
Diluted (loss) income per share	**(0.01)**	0.09	(0.01)
FINANCIAL POSITION			
Net capital expenditures	**1,206**	557	1,224
Total assets	**42,193**	68,635	54,961
Bank indebtedness and long-term debt	**266**	7,114	13,532
Shareholders' equity	**23,551**	24,041	566
Net book value per share	**0.08**	0.09	0.00
Ratio: debt/equity	**0.01**	0.30	23.91
Ratio: current assets/current liabilities	**1.79**	1.43	1.62
Shares outstanding at period end	**280,391,152**	254,898,072	201,994,113

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards (IFRS).
2. Comparative figures for the Consolidated Financial Statements as at December 31, 2013 and for the year then ended have been reclassified to conform to the December 31, 2013 presentation.

Revenues increased in 2012 relative to 2011 as growing deliveries for defense programs exceeded the reduction in revenues caused by the wind-down of certain commercial programs. Although defence program revenues continued to increase into 2013, the current year represented the first full year within the three year period presented, which did not have any revenue from Cessna Aircraft Company ("Cessna"), and consequently revenues have been reduced.

Year-on-year EBITDA remains consistent as a percentage of revenue, with the exception occurring in 2012 when the Company received an arbitration award amounting to $27,391,000.

Cash received from the Cessna arbitration award settlement in 2013 allowed the Company to repay its convertible debenture as well as redeem its preferred shares and pay dividends accrued thereon. Capital expenditures during the three year period presented have been limited to upgrading manufacturing equipment and capabilities, as well as information technology assets.

Quarterly Results

The following table provides selected unaudited quarterly consolidated financial information for the eight most recent fiscal quarters to December 31, 2013 prepared in accordance with International Financial Reporting Standards ("IFRS").

QUARTERLY RESULTS

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

	2013				2012			
FOR THE THREE MONTHS ENDED	**Dec 31**	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	**$ 17,159**	$ 19,767	$ 20,492	$ 19,946	$ 19,815	$ 19,324	$ 25,192	$ 25,006
Operating income (loss)	**(2,637)**	(211)	393	440	24,177	(1,446)	411	860
EBITDA[1]	**(1,580)**	514	3,066	1,241	26,633	(1,205)	1,656	1,951
Net income (loss)	**(2,367)**	(1,139)	1,596	108	23,206	(2,729)	13	151
EBITDA per share[1]								
Basic	**(0.01)**	0.00	0.01	0.00	0.10	(0.01)	0.01	0.01
Diluted	**(0.01)**	0.00	0.01	0.00	0.10	(0.01)	0.01	0.01
Net income (loss) per share								
Basic	**(0.01)**	(0.00)	0.01	0.00	0.09	(0.01)	0.00	0.00
Diluted	**(0.01)**	(0.00)	0.01	0.00	0.09	(0.01)	0.00	0.00
Long-term debt	**67**	3,672	3,835	4,138	4,300	4,409	11,800	12,081

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS").

2013 and 2012 Results Overview

During the year ended December 31, 2013, the Company recorded a loss from operations of $2,015,000 on $77,364,000 revenue, as compared to $24,002,000 operating income on $89,337,000 revenue for the preceding year; and a net loss for the current year of $1,802,000 as compared to net income of $20,641,000 for the year ended December 31, 2012.

On November 16, 2012, the Company received the determination of an appointed arbitration panel constituted to adjudicate outstanding issues relating to cost reimbursements and compensation payable to the Company in connection with the transition of Cessna Aircraft Company ("Cessna") production work back to Cessna and other suppliers. The quantum of damages was assessed by the arbitration panel in 2012 at US$27,391,000.

On September 5, 2013 the Company entered into a settlement agreement, from a court directed mediation with Cessna, which settled all outstanding litigation between the Company and Cessna. The settlement required payment by Cessna of US$27,964,000 ($29,380,000) in satisfaction of the judgement entered against Cessna from the arbitration award made on November 16, 2012, resulting in US$573,000 ($604,000) recorded as additional award settlement for 2013. The settlement funds were received in full by the Company on September 6, 2013. This settlement satisfies the judgement and has resulted in the dismissal of the outstanding appeal.

The Company operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The contracts provide for long lead-time orders; the civil aerospace business is also slightly seasonal as some aircraft manufacturers reduce or suspend production in December and for a period of time in the summer. The Cessna program revenue wind-down culminating during the third quarter 2012 reduced the Company's quarterly revenues in 2013 relative to 2012. However, a significant increase in deliveries for the F-35 Carrier Variant Outboard Wing ("CV-OBW") during 2013 has somewhat mitigated the commercial program revenue reduction.

The Company continues to actively pursue production contracts on aerospace programs throughout North America, Asia, and Europe both in the commercial and defense aerospace sectors. The Company is expending significant resources with a focused business development strategy to grow revenues with a targeted customer approach and where beneficial, aligned with the Government of Canada Defence Procurement Strategy leveraging Industrial and Technological Benefits (ITBs).

There remains within operations significant levels of unutilized plant capacity. The Company has expensed $4,926,000 of overhead costs during the current year (December 31, 2012: $4,660,000) in respect of unutilized plant capacity. The amount of overhead costs expensed as a result of unutilized capacity will fluctuate from quarter to quarter as production in support of deliveries varies. Revenue growth would benefit Company profitability via a contribution to the recovery of fixed overhead expenditures.

The current year loss includes a $1,085,000 foreign exchange gain resulting from holding foreign currency denominated cash, accounts receivable (primarily arising from the Cessna arbitration award) and accounts payable; while the income for the year ended December 31, 2012 included a $193,000 foreign exchange loss.

On June 27, 2013 an arbitration ruling upheld the Company's decision to terminate certain employees. This decision has created a follow-on restructuring provision amounting to approximately $569,000 which has been recorded during the current year.

Cash flows from operating activities during the year ended December 31, 2013 provided $23,849,000 of cash as compared to providing $6,109,000 of cash during the year ended December 31, 2012. The primary source of cash from operations during the current year is from the Cessna award settlement. The Company utilized the funds received from the Cessna award settlement to repay $6,660,000 of bank indebtedness, a $4,045,000 convertible debenture, and $11,803,000 preferred shares and accrued dividends leaving $6,872,000 of cash from the Cessna award settlement for funding operations. As at December 31, 2013 the Company had $7,012,000 cash on hand. The Company has a working capital surplus of $14,213,000 as at December 31, 2013 which has decreased from the December 31, 2012 $16,759,000 surplus, as a result of repaying bank indebtedness from Cessna award settlement proceeds. The Company's accumulated deficit as at December 31, 2013 is $57,723,000 (December 31, 2012: $55,921,000).

Revenue

Revenue for the year ended December 31, 2013 was $77,364,000 as compared to $89,337,000 for the year ended December 31, 2012. Current year revenues have decreased relative to the previous year primarily as a result of the wind-down of Cessna programs, offset by increased deliveries for the F-35 CV-OBW program.

Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

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

FOR THE YEAR ENDED DECEMBER 31	2013		2012	
	Revenue	% of Total	Revenue	% of Total
BAE Systems	**$ 22,604**	**29.2**	$ 15,193	17.0
Boeing	**28,167**	**36.4**	29,961	33.6
Bombardier	**16,370**	**21.2**	16,784	18.8
Cessna	**-**	**-**	14,055	15.7
Other	**10,223**	**13.2**	13,344	14.9
Total	**77,364**	**100.0**	89,337	100.0

During the year ended December 31, 2013, the Company delivered its highest quantity of the F-35 Carrier Variant Outboard Wing ("CV-OBW") 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 the single source supplier for this critical assembly under contract with BAE, and delivers directly to Lockheed Martin. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35 aircraft which allows for handling and storage of the aircraft on the aircraft-carrier's deck and hangers, while keeping its long-range and low-landing speed flight characteristics. The Outboard Wing has been successfully fitted onto the first production standard F-35 carrier version.

$22,604,000 of revenues generated by the F35 program during 2013 reflects production and non-recurring program introduction revenue streams; a 49% increase in revenues over the year ended December 31, 2012.

Shipments of large assemblies to Boeing Commercial Airplane Group ("Boeing CA"), primarily for the 737 commercial jet program, dropped by 6% as a result of customer directed inventory management during the fourth quarter 2013, relative to 2012; while deliveries of fabricated parts increased by 32%. The Company also delivered components to Boeing Defense, Space & Security ("Boeing DSS") for the Chinook CH47 helicopter. This program produced revenues which were 44% lower in the current year than the comparable year in 2012. This near term reduction of Chinook CH47 helicopter program revenue will in part be offset by delivery of additional components for this aircraft commencing in the second half of 2014. The Company continues to work towards obtaining additional new contracts supporting Boeing commercial jet programs as well as Boeing DSS defense programs.

The Company announced that it has received, for a third consecutive year, a 2013 Silver Boeing Performance Excellence Award. The Boeing Company issues the award annually to recognize suppliers who have achieved superior performance. Avcorp maintained a Silver composite performance rating for each month of the 12-month performance period, from October 1, 2012, to September 30, 2013.

This year, Boeing recognized 582 suppliers who achieved either a Gold or Silver level Boeing Performance Excellence Award. Avcorp is one of only 458 suppliers to receive the Silver level of recognition.

Revenues from Bombardier Aerospace ("Bombardier") programs remained relatively consistent during the current year relative to the year ended December 31, 2012. Shipments of large assemblies for the CL605 business jet program decreased by 4% during the current year, while the Company experienced a substantial (20%) increase in the delivered quantity of composite floor boards for the CRJ aircraft programs. The Company's primary source of revenues from Bombardier in 2014 will continue to be from components for the CL605 and CL850 business jets, and composite floor boards for the CRJ and Q400 aircraft programs.

Revenues from Cessna Aircraft Company decreased by $14,055,000 during the year ended December 31, 2013, relative to 2012, as Cessna completed its transition of production work from the Company.

Other revenues, primarily generated by Comtek, saw a 15% increase in aircraft component repairs offset by a decrease in sales of composite parts to an original equipment manufacturers (“OEM”) due to a one-time sale occurring in 2012.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2013 was 12.5% of revenue as compared to 13.0% of revenue for the year ended December 31, 2012.

The Company was able to maintain its gross margin percentage during the current year as a result of having a favourable program mix.

Gross profit has decreased during 2013 relative the previous year (December 31, 2013: $9,654,000; December 31, 2012: $11,615,000) due to reduced revenues.

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, the administration and general expenses decreased to 15.1% for the year ended December 31, 2013 from 16.2% for the year ended December 31, 2012. In absolute terms, administration and general costs incurred during the current year were reduced by $2,835,000 relative to the prior year as expenditures in support of contract terminations diminished.

Foreign Exchange Gain or Loss

The Company recorded a $1,085,000 foreign exchange gain 2013 (December 31, 2012: $193,000 loss) as a result of holding US dollar denominated receivables, payables and debt. Changes in the Canadian dollar equivalent of balances arising from the settlement agreement with Cessna were the primary cause for the foreign exchange gain during the current year.

Earnings Before Interest, Taxes, Depreciation & Amortization

The Company presents earnings before interest, taxes, depreciation and amortization (“EBITDA”) to assist the Company’s stakeholders with their assessment of its financial performance. EBITDA is a financial measure not recognized as a term under IFRS. However, the Company’s management believes that the Company’s stakeholders consider this metric to be useful information to assist them in evaluating profitability and liquidity.

Earnings before interest, taxes, depreciation and amortization (EBITDA) was positive $3,241,000 for the year ended December 31, 2013 compared to a positive EBITDA of $29,035,000 for the year ended December 31, 2012. Year-on-year EBITDA remains relatively constant as a percentage of revenue, with the exception occurring in 2012 when the Company received an arbitration award amounting to $27,391,000.

EBITDA[1]

unaudited, expressed in thousands of Canadian dollars

FOR THE YEAR ENDED DECEMBER 31	**2013**	2012
Income (loss) for the period	**$ (1,802)**	$ 20,641
Interest expense and financing charges	**927**	2,116
Income tax expense	**-**	-
Depreciation	**2,082**	3,012
Amortization of development costs	**2,034**	3,266
	3,241	29,035

1. This is not a recognized term under International Financial Reporting Standards.

Finance Costs

Total interest and financing charges on both short- and long-term debt for the year ended December 31, 2013 was $927,000 as compared to $2,116,000 for 2012. The decrease in interest and financing charges for 2013 is primarily as a result of the Company repaying a significant portion of its current long-term debt during the second half of 2012. Included within interest expense and financing charges for the year ended December 31, 2013 are $657,000 of accrued preferred share dividends (December 31, 2012: $756,000).

Income Taxes

The Company has not incurred a tax expense during the current year (December 31, 2012: $Nil).

Income or Loss

Loss for the year ended December 31, 2013 was $1,802,000 as compared to $20,641,000 income for the year ended December 31, 2012. A $569,000 restructuring provision, as well as a $1,085,000 foreign exchange gain has significantly impacted income for the current year.

On September 5, 2013 the Company entered into a settlement agreement, from a court directed mediation with Cessna, which settled all outstanding litigation between the Company and Cessna. The settlement required payment by Cessna of US$27,964,000 ($29,380,000) in satisfaction of the judgement entered against Cessna from the arbitration award made on November 16, 2012. The settlement funds were received in full by the Company on September 6, 2013. This settlement satisfies the judgement and has resulted in the dismissal of the outstanding appeal.

This settlement agreement netted the Company an additional $604,000 other operating income in 2013 as a result of pre-judgement interest awarded.

Liquidity and Capital Resources

The Company's operating line of credit provides for a total utilization of $12,000,000. The Company ended the current year with bank operating line utilization of $Nil compared to utilization of $2,122,000 as at December 31, 2012. The Company's banking agreement with a Canadian Chartered bank expires on September 27, 2015. In accordance with the terms of its banking agreement, the bank has instituted a cure amount for a December 31, 2013 non-compliance with a specified fixed charge coverage ratio.

During fiscal 2013 and 2012 the Company has repaid in excess of $26 million of debt and has cash reserves on hand as at December 31, 2013 amounting to $7,012,000 (December 31, 2012: $2,597,000).

Management is actively working to secure additional production orders, has completed loan financing and renegotiated debt repayments, will continue to work with existing common and preferred 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 $3,522,000 of cash for the year ended December 31, 2013 compared to providing $30,451,000 of cash during the previous year, with depreciation and development cost amortization amounting to $4,116,000 in 2013 (December 31, 2012: $6,905,000).

Non-cash operating assets and liabilities provided an additional $20,327,000 of cash during the current year, compared to utilizing $24,342,000 of cash during 2012. Receipt of $29,380,000 in settlement of the Cessna award judgement was the primary contributor of cash during the current year; while working capital has been reduced as revenues diminished in 2013. The Company continues to closely monitor accounts receivable in order to ensure cash is collected on a timely basis.

For the year ended December 31, 2013, proceeds from funding of program introduction and working capital amounted to $7,252,000 (December 31, 2012: $9,712,000); while deferred revenues recognized as income during the current year amounted to $17,514,000 (December 31, 2012: $11,576,000).

Cash Flows from Investing Activities

During the current year, the Company purchased capital assets totalling $1,206,000 as compared to $557,000 during the year ended December 31, 2012. The Company continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

Additionally, the Company invested $556,000 during the current year (December 31, 2012: $1,071,000) in tooling and new program introduction. Current year expenditures primarily relate to investment in the production development and supply of a prototype Ruddevator, a flight control system for stabilization and directional control of air-to-air refuelling booms for the KC-135 Tanker fleet, as well as tooling and new program introduction costs for the components on the Chinook CH47 Helicopter program.

Cash Flows from Financing Activities

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

On May 9, 2013, the Company completed a private placement of 25,489,807 common shares at $0.049 per share for gross proceeds of approximately $1,249,000 (December 31, 2012: 23,172,552 common shares for proceeds of $973,000). The subscriber in the private placement was Panta Canada B.V., which owns 64.4% of the Company's common shares as at December 31, 2013. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

During the year ended December 31, 2013, the Company repaid its bank debt facility utilizing $6,660,000 of the funds received from the Cessna settlement agreement (December 31, 2012: $2,122,000 increase in bank debt facility). Interest paid during the current year on current and long-term debt was reduced to $323,000 as compared to $1,144,000 for the year ended December 31, 2012, as a significant portion of the Company's debt was repaid during 2013.

Also during the current year, the Company repaid long-term debt consisting of $77,000 of equipment financing (December 31, 2012: $882,000) and a $258,000 of accrued government royalties (December 31, 2012: $731,000).

During the fourth quarter 2013 the Company redeemed its Series A First Preferred Shares and paid accrued dividends amounting to $11,803,000 (December 31, 2012: $Nil).

During the fourth quarter 2013, the Company repaid in full the Export Development Canada convertible debenture; the principal amount repaid during the year was $4,338,000. In 2012, a $6,000,000 term loan was repaid.

On December 31, 2013, the ratio of the Company's current assets to current liabilities was 1.79:1 (December 31, 2012: 1.43:1), with the debt to equity ratio at 0.01:1 (December 31, 2012: 0.30:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	Total	2013	2014 – 2016	2017 – 2018	Post 2018
Finance lease obligations	**$ 132**	$ 65	$ 67	$ -	$ -
Purchase obligation[1]	**25,110**	15,263	7,967	1,756	124
Other long-term obligations[2]	**134**	134	-	-	-
Total contractual obligations	**25,376**	15,462	8,034	1,756	124

1. Purchase obligations include payments for the Company's operating and property leases, as well as committed contractual operational purchase order obligations outstanding.
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 does not have any off-balance sheet liabilities or transactions that are not recorded or disclosed in the consolidated financial statements.

Capital Stock

As at March 31, 2014, there were 280,391,152 common shares, 19,550,532 common shares purchase warrants, and 10,535,500 stock options issued and outstanding.

Preferred Shares

On July 10, 2006, the Company issued 1,200,000 Series A First Preferred Shares (the "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 and charged against equity. The amount of issuance costs has been reflected within preferred shares upon redemption. The comparative December 31, 2012 preferred shares liability and corresponding deficit balance within equity as disclosed on the Consolidated Statement of Financial Position have been reclassified by $546,000 to present the gross proceeds payable at that time.

The preferred shares provided for a 9.25% per annum dividend, payable quarterly in cash on the last day of March, June, September and December.

During 2013, the Company filed a notice of redemption for its preferred shares notifying preferred shareholders that the preferred shares together with all dividends accrued thereon were to be paid on November 14, 2013, upon receipt of original Series A First Preferred Share Certificates at the registered offices of the Company. Preferred shares amounting to $8,134,000 along with $3,669,000 accrued dividends thereon were paid during the fourth quarter 2013. $25,000 preferred shares and $11,000 of accrued dividends remain unpaid as at the reporting date. Subsequent to the end of the year the remaining $25,000 preferred shares and $11,000 of accrued dividends were paid.

Common Shares

On May 9, 2013, the Company completed a private placement of 25,489,807 common shares at $0.049 per share for gross proceeds of approximately $1,249,000. The subscriber in the private placement was Panta Canada B.V., which owns 64.4% of the Company's common shares as at December 31, 2013. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

On August 12, 2013, a holder of preferred shares converted 900 preferred shares resulting in the issuance of 3,273 common shares at $2.75 per share for a book value of $9,000.

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, 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 280,391,152 common shares issued at December 31, 2013. The book value of common shares issued and outstanding as at December 31, 2013 was $77,681,000 (December 31, 2012: $76,423,000).

Changes in Accounting Standards

The following is a brief summary of the new standards which were implemented during the current year:

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. 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.

Implementation of these standards did not have a material impact on the consolidated financial statements of the Company.

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.

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.

IFRIC 21 – Levies

In May 2013, the International Accounting Standards Board (IASB) issued International Financial Reporting Standards Interpretations (IFRIC) 21 Levies, which was developed by the IFRS Interpretations Committee (“the Committee”). The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognized before the specified minimum threshold is reached. The interpretation is applicable for annual periods beginning on or after January 1, 2014. Early application is permitted. The Company is currently evaluating the impact of IFRIC 21 on its consolidated financial statements.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2013 were at planned levels for BAE, Boeing, and Bombardier 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 2013 to December 2017 and with Boeing Defense, Space and Security extending from 2013 into 2017 with established minimum base delivery quantity requirements. Agreements with BAE Systems (Operations) Limited extend to January 2016 and continue to generate additional sales order backlog. The Bombardier 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, 2013, is $197 million, ($73 million of which pertains to 2014), compared to $214 million as at December 31, 2012. The changes in order backlog are as follows:

- $77 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2013;
- $53 million increase in order backlog due to increases in the production rates and contract renewals for various existing programs, as well as recently awarded statements of work; and
- $7 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.

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 $14,213,000 at December 31, 2013 and $16,759,000 at December 31, 2012. The decrease in working capital during 2013 was primarily due to repaying bank indebtedness and redeeming preferred shares and accrued dividends from the Cessna settlement proceeds.

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 have and continue to be made, and that those investments along with the expected continued financial support of shareholders and lenders 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, business systems, technologies, processes and qualifications. 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, 2013 was 412 (December 31, 2012: 476). 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 or terminated customer programs not replaced;
- 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.

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 CA have been renewed and extend from January 2013 to December 2017. Agreements with Boeing DSS have been renewed and established which extend from 2013 into 2017 with minimum base quantity requirements.

BAE customer contracts extend to January 2016. The Company is currently negotiating the extension of these contracts.

The Company also faces the risk that the wind-down of Cessna program contracts are not replaced on a timely basis thereby causing the Company to continue to bear significant levels of expenses related to under-utilized capacity. The Company has restructured its business development strategy in order to best mitigate this risk.

Procured Materials and Parts

Delivery of the First Article Inspection parts and components for the Joint Strike Fighter F-35 program successfully met the Company's internal target dates for its first lot of production (LRIP4). During transition of work from a supplier for LRIP5, issues with the start-up of a new supplier have delayed shipments to the Company and had impacted schedule. The Company, with its customer, have managed issues related to the delay in supplier production, start-up with recovery schedules and corrective actions implemented. LRIP5, the second lot of production, has been fully delivered.

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

Aircraft Production Rates

The following industry and program trends impact the Company.

- Company research indicates that the aerostructures markets for commercial aircraft and larger business jets would continue to grow beyond 2014. The lighter business jets market is expected to remain soft around current rates.
- Growth in air travel rates has and will further increase production rates on the Boeing 737 and Airbus A320 platforms in the coming years. The regional aircraft market remains soft around current rates.
- Bombardier Challenger aircraft production rates remained flat in 2013, the build rates are expected to reduce slightly in 2014 then remain relatively flat at 2014 rates through 2017.
- The market for defence aircraft continued to grow into 2013, albeit at a slower pace due to general global budget challenges. Defence spending in North America and Europe is expected to decrease in the near term.
- The F35 remains, on a global scale, one of the largest Defence Airplane programs for the foreseeable future.
- However, under the current North American Federal Governments' initiatives of cost controls regarding defence spending, there exists a risk that the customer demand for defence aircraft components is reduced or delayed.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exists to provide additional revenue from this aerospace sector.

Competitors

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

Cost Reductions

Approximately 54% of the Company's cost of sales is related to labour and overhead and 46% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its Western European and north western United States competitors and higher than those in the south eastern United States, Asia, Eastern Europe and Mexico. On July 30, 2013 the Company and its labour force ratified a new six year collective agreement. The agreement was ratified by a two-thirds majority, with the new agreement expiring on March 31, 2019.

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 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 decreases, the equivalent value of US dollar denominated revenues increases; conversely, the cost of US dollar denominated purchases will increase. The Company is continuing 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 extend past 2020. The Company expects to finance investment in the start-up of new military defence programs primarily by milestone payments from customers, though this cannot be assured. With the exception of capital expenditures required for new programs, the Company's investment in new equipment will be maintained at 2013 levels.

Boeing will be the Company's largest customer in 2013, followed by BAE and Bombardier. The Company forecasts its 2014 revenues to fall approximately 6% below 2013 levels as deliveries for Bombardier programs are forecasted to be reduced.

The Company forecasts its working capital financing requirements for 2013 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

During the current year a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. who's wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 64.4% of the issued and outstanding common shares on December 31, 2013. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the year ended December 31, 2013 amounted to $690,000 (December 31, 2012: $38,000). Fees payable to Panta Holdings B.V. as at December 31, 2013 are $170,000 (December 31, 2012: $17,000). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $843,000 for the year ended December 31, 2013 (December 31, 2012: $55,000).

During the year ended December 31, 2013, 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, 2013 amounted to $81,000 (December 31, 2012: $62,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2013 are $Nil (December 31, 2012: $14,000). These fees are included in the consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $67,000 for the year ended December 31, 2013 (December 31, 2012: $76,000).

On May 9, 2013, the Company completed a private placement of 25,489,807 common shares at $0.049 per share for gross proceeds of approximately $1,249,000. The subscriber in the private placement was Panta Canada B.V., which owns 64.4% of the Company's common shares as at December 31, 2013. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

Fourth Quarter

The following summarizes financial results for the fourth quarter 2013.

Operating loss for the fourth quarter of 2013 was $2,637,000 from $17,159,000 in revenues, as compared to operating income of $24,177,000 from $19,815,000 in revenues for the quarter ended December 31, 2012. The major contributing factor for operating income for the fourth quarter of 2012 was on November 16, 2012 Avcorp received the determination of an appointed arbitration panel constituted to adjudicate outstanding issues relating to cost reimbursements and compensation payable to Avcorp in connection with the transition of Cessna production work back to Cessna and other suppliers.

The binding arbitration award was delivered to the Company on November 16, 2012. The quantum of damages was assessed by an arbitration panel at $27,391,000. The arbitration award, net of associated costs, amounted to $21,548,000 in 2012.

The fourth quarter 2013 operating loss is primarily attributable to reduced revenues as customers managed their inventories to reduced levels.

On October 15, 2013, the Company repaid in full the Export Development Canada convertible debenture. The principal amount repaid was $4,038,000. Accrued interest amounting to $7,000 was also repaid. The debenture has been extinguished and no further amounts are owed.

During 2013, the Company filed a notice of redemption for its preferred shares notifying preferred shareholders that the preferred shares together with all dividends accrued thereon were to be paid on November 14, 2013, upon receipt of original Series A First Preferred Share Certificates at the registered offices of the Company. Preferred shares amounting to $8,134,000 along with $3,669,000 accrued dividends thereon were paid during the fourth quarter 2013. $25,000 preferred shares and $11,000 of accrued dividends remain unpaid as at the reporting date. Subsequent to the end of the year the remaining $25,000 preferred shares and $11,000 of accrued dividends were paid.

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 consolidated financial statements for the year ended December 31, 2013.

Critical Accounting Estimates and Judgment

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and judgments 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, on the consolidated balance sheet as at December 31, 2013 amounting to $8,704,000 (December 31, 2012: $9,633,000). Reduction in market demand during 2009 for business jet aircraft and the wind-down of deliveries in 2012 for Cessna programs resulted in periodic negative operating cash flows during the subsequent years. 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. 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, 2013, $1,240,000 (December 31, 2012: $2,718,000) in unamortized deferred tooling costs, which are expected to have a future economic benefit, are presented as Development costs in the consolidated statements of financial position. Development costs of $585,000 (December 31, 2012: $587,000) are internally generated and 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 $4,926,000 of overhead costs during the current year (December 31, 2012: $4,660,000) in respect of unutilized plant capacity.
- Warranty provisions are provided for when an actual production 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 previous years, the Company provisioned for $85,000 of expected warranty expenditures relating to a manufacturing deficiency. All rectifications have been completed by the date of this report, and $85,000 provisioned in previous periods has been reversed in 2013.
- Deferred non-recurring program revenues are recognized as revenue straight-line on units-of-production basis over the expected life of the program; where expected life is an estimate based on customer and industry data, or as non-recurring activities are completed.
- Other receivable is based on a binding arbitration award under which a quantum of damages was assessed and a period for payment was established.

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 0.5%. The maximum operating line of credit availability is $12,000,000 of which $Nil is utilized as at December 31, 2013 (December 31, 2012: $2,122,000). 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, 2013, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2012: $21,000) impact on net earnings and cash flow.

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 2013 was $1,085,000 as compared to a $193,000 loss for the year ended December 31, 2012.

The Company had the following US dollar denominated balances:

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Bank cash position	**$ 2,350**	$ 2,197
Accounts receivable	**4,750**	2,934
Accounts payable net of prepayments	**1,109**	1,329

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 $599,000 in net earnings for the year ended December 31, 2013 (December 31, 2012: $380,000 increase (decrease) 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 counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group (Boeing), Boeing Defense, Space & Security (BDS), Bombardier Aerospace (Bombardier) and BAE Systems (Operations) Limited (BAE). During 2013 and 2012, 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 consolidated statements of financial position.

As at the consolidated statements of financial position date 80.4% (December 31, 2012: 73.1%) 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.

Capital Risk

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.

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 Vice President, Finance 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, 2013 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, 2013, 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 consolidated 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 consolidated financial statements of Avcorp Industries Inc. and all other information contained in the Management Discussion and Analysis are the responsibility of management. The consolidated 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 consolidated financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information. As at 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 auditors' report

To the Shareholders of Avcorp Industries Inc.

We have audited the accompanying consolidated financial statements of Avcorp Industries Inc., which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, and the consolidated statements of (loss) income and comprehensive (loss) income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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.

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' 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 auditors consider 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. as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP	**ERNST & YOUNG LLP** Chartered Accountants

Vancouver, British Columbia
March 31, 2014

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

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

AS AT DECEMBER 31	2013	2012
ASSETS		
Current assets		
Cash (note 14)	**$ 7,012**	$ 2,597
Accounts receivable (note 9)	**8,845**	7,944
Inventories (note 10)	**14,940**	16,572
Prepayments and other assets	**1,306**	1,634
Other receivable (note 11)	**-**	27,391
	32,103	56,138
Non-current assets		
Prepaid rent	**146**	146
Development costs (note 12)	**1,240**	2,718
Property, plant and equipment (note 13)	**8,704**	9,633
Total assets	**42,193**	68,635
LIABILITIES AND EQUITY		
Current liabilities		
Bank indebtedness (note 14)	**-**	2,122
Accounts payable and accrued liabilities (note 15)	**7,645**	7,859
Current portion of long-term debt (note 18)	**199**	692
Preferred shares (note 21)	**36**	11,192
Deferred program revenues (note 16)	**10,010**	17,514
	17,890	39,379
Non-current liabilities		
Deferred gain	**216**	263
Lease inducement	**469**	567
Long-term debt (note 18)	**67**	4,300
Warranty provisions	**-**	85
	18,642	44,594
Equity		
Capital stock (note 20)	**77,681**	76,423
Contributed surplus	**3,593**	3,539
Deficit	**(57,723)**	(55,921)
	23,551	24,041
Total liabilities and equity	**42,193**	68,635

Nature of operations (note 1)
Critical accounting estimates and judgements (note 4)
Obligations and commitments under finance and operating leases (note 19)
Subsequent events (note 31)

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

Approved by the Board of Directors on March 31, 2014

David Levi
Chairman

Eric Kohn TD
Committee Chair,
Audit & Corporate Governance Committee

CONSOLIDATED STATEMENTS OF (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME

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

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Revenues	**$ 77,364**	$ 89,337
Cost of sales	**67,710**	77,722
Gross profit	**9,654**	11,615
Administrative and general expenses	**11,682**	14,517
Office equipment depreciation	**591**	487
Other operating (income) (note 11)	**(604)**	(27,391)
Operating (Loss) Income	**(2,015)**	24,002
Finance costs (note 24)	**927**	2,116
Foreign exchange (gain) loss	**(1,085)**	193
Loss on repayment of debt	**-**	397
Gain on disposal of equipment (note 13)	**(108)**	-
Write-down of equipment (note 13)	**53**	655
(Loss) Income before income tax	**(1,802)**	20,641
Income tax expense (note 27)	**-**	-
(Loss) Income and total comprehensive (loss) income for the period	**(1,802)**	20,641
(Loss) Earnings per share:		
Basic (loss) earnings per common share (note 29)	**(0.01)**	0.09
Diluted (loss) earnings per common share (note 29)	**(0.01)**	0.09
Basic weighted average number of shares outstanding (000's)	**271,380**	217,775
Diluted weighted average number of shares outstanding (000's)	**271,380**	218,084

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 YEAR ENDED DECEMBER 31	2013	2012
Cash flows from (used in) operating activities		
(Loss) Income before income tax	**$ (1,802)**	$ 20,641
Adjustment for items not affecting cash:		
Accretion on convertible loan	**-**	67
Accrued interest and government royalties	**270**	1,161
Depreciation	**2,082**	3,012
Development cost amortization	**2,034**	3,893
Fair value of warrants amortization	**-**	132
Loss on repayment of debt	**-**	397
Preferred share dividends accrued	**657**	756
Provision for loss-making contracts	**51**	(189)
Provision for obsolete inventory	**335**	(67)
Stock based compensation	**54**	115
Warranty provision	**(85)**	-
Write-down of equipment	**53**	655
Other items	**(127)**	(122)
	3,522	30,451
Changes in non-cash working capital		
Accounts receivable	**1,858**	4,908
Inventories	**1,246**	3,102
Prepayments and other assets	**326**	(244)
Other receivable	**27,391**	(27,391)
Accounts payable and accrued liabilities	**(232)**	(2,853)
Deferred program revenues (note 16)	**(10,262)**	(1,864)
Net cash from (used in) operating activities	**23,849**	6,109
Cash flows from (used in) investing activities		
Purchase of equipment	**(1,206)**	(557)
Payments relating to development costs and tooling	**(556)**	(1,071)
Net cash from (used in) investing activities	**(1,762)**	(1,628)
Cash flows from (used in) financing activities		
(Decrease) in bank indebtedness	**(2,122)**	2,122
Payment of interest	**(323)**	(1,144)
Proceeds from issuance of common shares	**1,249**	973
Redemption of preferred shares and accrued dividends	**(11,803)**	-
Repayment of current and long-term debt	**(4,415)**	(6,882)
Repayment of government royalties	**(258)**	(731)
Net cash from (used in) financing activities	**(17,672)**	(5,662)
Net increase (decrease) in cash	**4,415**	(1,181)
Cash - Beginning of year	**2,597**	3,778
Cash - End of year	**7,012**	2,597

Supplementary Cash Flow Information (note 25)

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 loan	Contributed surplus	Deficit	Total equity
	Shares	**Amount**				
Balance December 31, 2011	201,994,113	$ 73,251	$ 453	$ 3,424	$ (76,562)	$ 566
Issue of common shares (notes 20c,d,e,f,g,h and i)	52,903,959	2,966	-	-	-	2,966
Loan conversion	-	206	(453)	-	-	(247)
Stock based compensation expense (note 22)	-	-	-	115	-	115
Income for the period	-	-	-	-	20,641	20,641
Balance December 31, 2012	254,898,072	76,423	-	3,539	(55,921)	24,041
Issue of common shares (notes 20a and b)	25,493,080	1,258	-	-	-	1,258
Stock-based compensation expense (note 22)	-	-	-	54	-	54
Loss for the period	-	-	-	-	(1,802)	(1,802)
Balance December 31, 2013	**280,391,152**	**77,681**	**-**	**3,593**	**(57,723)**	**23,551**

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

1. Nature of operations

Avcorp Industries Inc. (the "Company" or "Avcorp") 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.

We operate from two locations in Canada. Comtek Advanced Structures Ltd. ("Comtek"), a wholly owned subsidiary, is located in Ontario and is dedicated to composites manufacturing and repairs. Avcorp Industries Inc. is located in British Columbia and is dedicated to light weight metal manufacturing and assembly.

The Company's governing corporate statute is the Canada Business Corporations Act (the "CBCA").

The consolidated financial statements of the Company for the year ended December 31, 2013 were authorized for issue in accordance with a resolution of its Board of Directors on March 31, 2014.

2. Basis of preparation and measurement

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments that have been measured at fair value. The consolidated financial statements are presented in Canadian dollars and all values are rounded to the nearest thousand (000), except when otherwise indicated.

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.

Basis of consolidation

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

Subsidiaries are those 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 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 consolidated 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 consolidated statement of income.

Fair value measurement

Financial instruments, such as, derivatives are measured at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortized cost are disclosed in notes 7f and 8.

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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to the Company. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Company determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

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 consolidated statements of financial position 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: The Company's financial assets and liabilities included in other assets are inflation derivative assets arising from the Company's sales contracts having price adjustment clauses within their terms. A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of income. Gains and losses arising from changes in fair value are presented in the consolidated 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 consolidated statements of financial position 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.

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

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 consolidated 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 depreciated 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 depreciation 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 consolidated statement of income.

Impairment of non-financial assets

Property, plant and equipment is tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash in-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.

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 quarterly, 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 where the effect is material.

Provisions

Provisions for warranties, where applicable, are recognized 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.

The Company's major revenue streams arise from the production and supply of major airframe structures and aircraft parts to aircraft manufacturers, the repair of aircraft components, aircraft product design and production tooling design and manufacture.

The nature of the Company's operating cycle for the manufacture and delivery of highly engineered aerospace parts and components is one in which significant order and production lead-times exist. There exists a high degree of variability within the length of operating cycles for the various manufactured components, aircraft programs, and customers. The Company's operating cycle commences with receipt, from its customers, of a purchase order for production of a component and culminates when the Company has received full payment from the customer for the product it has delivered. The individual product component operating cycles can range from twelve weeks to greater than sixty weeks. Costs incurred for proto-type design, as well as hard and soft tooling expenditures for new program introduction can occur over a two year period. Given this variability, since no single operating cycle is clearly identifiable, the Company has concluded that the operating cycle is 12 months.

Certain program inventories have been funded by a customer, whereby the associated deferred program revenues will be recorded as revenue upon delivery of units of production.

Additionally, customers have funded non-recurring costs incurred during the introduction of new production programs. These costs are deferred as development costs and will be amortized to income straight-line over the contract period or on a units-of-production basis over the expected life of the programs, in conjunction with the associated deferred revenue upon commencement of production.

Deferred program revenues are classified as current or non-current based on the estimated timing of when the related revenues are realized. This period of deferred revenue realization can extend, dependent on the amortization of the related costs, over one or more fiscal years.

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

a) Current income tax

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where the Company operates and generates taxable income.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the income statement. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

b) Deferred tax

Deferred tax is provided using the liability method on deductible temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets are recognized for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognized outside profit or loss is recognized outside profit or loss. Deferred tax items are recognized in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

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 consolidated 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 (loss) income 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.

Government assistance

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

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

Convertible loans and debentures

Upon issuance, convertible debentures and loans are classified into their equity and liability components based on the fair value of the 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 lease that transfers substantially all the benefits and risks incident to the ownership of property is classified as a finance lease. All other leases are accounted for as operating leases whereby lease payments are expensed on a straight-line basis over the term of the lease. 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.

Changes in Accounting Policies

The following is a brief summary of the new standards which were implemented during the current year:

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.

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.

Implementation of these standards did not have a material impact of the consolidated financial statements of the Company.

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 International Financial Reporting Standards Interpretations ("IFRIC") 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.

IFRIC 21 – Levies

In May 2013, the International Accounting Standards Board ("IASB") issued IFRIC 21 Levies, which was developed by the IFRS Interpretations Committee ("the Committee"). The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognized before the specified minimum threshold is reached. The interpretation is applicable for annual periods beginning on or after January 1, 2014. Early application is permitted. The Company is currently evaluating the impact of IFRIC 21 on its consolidated financial statements.

4. Critical accounting estimates and judgements

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and judgments 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 13) on the consolidated statements of financial position amounting to $8,704,000 (December 31, 2012: $9,633,000). 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 production 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 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, 2013, $1,240,000 (December 31, 2012: $2,718,000) in unamortized deferred tooling costs (note 12), which are expected to have a future economic benefit, are presented as Development costs in the consolidated statements of financial position. Development costs of $585,000 (December 31, 2012: $587,000) are internally generated and 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, 2013 provision for anticipated losses was $51,000 (December 31, 2012: $Nil). The increase in this provision from December 31, 2012 was primarily as a result of production inefficiencies caused by a re-distribution within customer programs of the plant workforce arising from employee lay-offs.

- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $4,926,000 of overhead costs during the current year (December 31, 2012: $4,660,000) 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 previous years, the Company provisioned for $85,000 of expected warranty expenditures relating to a manufacturing deficiency. All rectifications have been completed by the date of this report, and $85,000 provisioned in previous periods has been reversed in 2013.

- Deferred program revenues are recognized as revenue straight-line over the contract period; or on a units-of-production basis over the expected life of the program, where expected life is an estimate based on customer and industry data; or as non-recurring activities are completed.

- Other receivable is based on a binding arbitration award under which a quantum of damages was assessed and a period for payment was established.

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	2013	2012
Salary, wages and benefits	**$ 34,356**	$ 35,318
Raw materials, purchased parts and consumables	**30,066**	37,739
Depreciation and amortization	**4,116**	6,278
Other expenses and conversion of costs into inventory	**2,781**	2,110
Rent	**2,505**	2,363
Contracted services	**1,667**	1,791
Utilities	**1,063**	1,021
Transportation	**846**	739
Office equipment rental/maintenance	**583**	642
Travel costs	**559**	652
Insurance	**438**	445
Legal and audit fees	**422**	3,137
Plant equipment rental/maintenance	**360**	288
Royalties	**221**	203
	79,983	92,726

6. 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 consolidated statements of financial position.

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 20).

7. 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 2013 was $1,085,000 as compared to a $193,000 loss for the year ended December 31, 2012.

The Company had the following US dollar denominated balances:

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Bank cash position	**$ 2,350**	$ 2,197
Accounts receivable	**4,750**	2,934
Accounts payable net of prepayments	**1,109**	1,329

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

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 $599,000 in net income for the year ended December 31, 2013 (December 31, 2012: $380,000 increase (decrease) 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 counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group ("Boeing"), Boeing Defense, Space & Security ("BDS"), Bombardier Aerospace ("Bombardier") and BAE Systems (Operations) Limited ("BAE"). During 2013 and 2012, 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 consolidated statements of financial position.

As at the consolidated statements of financial position date 80.4% (December 31, 2012: 73.1%) of the Company's trade accounts receivable are attributable to these customers.

c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company seeks to manage liquidity risk through the management of its capital structure and financial leverage.

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 14). Long-term debt repayments are as outlined in note 18.

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

				December 31, 2013
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness	$ -	$ -	$ -	$ -
Long-term debt	16	183	67	-
Preferred shares	36	-	-	-
Trade payables	3,543	-	-	-

				December 31, 2012
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness	$ 2,122	$ -	$ -	$ -
Long-term debt	72	620	4,300	-
Preferred shares	11,192	-	-	-
Trade payables	3,954	-	-	-

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 0.5%. The maximum operating line of credit availability is $12,000,000 (note 14) of which $Nil is utilized as at December 31, 2013 (December 31, 2012: $2,122,000). 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, 2013, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2012: $21,000) impact on net earnings and cash flow.

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

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

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, 2013, the Company has $11,777,000 (December 31, 2012: $12,040,000) of firmly committed orders that include price adjustment clauses of this nature. A $2,000 gain has been recorded as a derivative gain for the year ended December 31, 2013 as compared to a $5,000 gain for the year ended December 31, 2012 as a result of the change in the fair value of the underlying embedded derivatives.

Purchase Contracts

The Company's purchase contracts do not have a price adjustment clause where the final purchase price is determined by certain indices in a period prior to the date of purchase.

Included in prepayments and other assets is $25,000 of inflation derivatives assets arising from the Company's sales contracts having price adjustment clauses within their terms (December 31, 2012: $27,000).

f) Financial Assets and Liabilities by Category

As at December 31, 2013 and 2012, the Company's financial assets and liabilities are categorized as follows:

				December 31, 2013
	Loans and receivables	**Held at fair value**	**Financial assets and liabilities at amortized cost**	**Total**
Financial Assets				
Accounts receivable	$ 8,845	$ -	$ -	$ 8,845
Commodity contracts	-	25	-	25
Financial Liabilities				
Accounts payable and accrued liabilities	-	-	7,645	7,645
Long-term debt	-	-	266	266
Preferred shares			36	36

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

				December 31, 2012
	Loans and receivables	**Held at fair value**	**Financial assets and liabilities at amortized cost**	**Total**
Financial Assets				
Accounts receivable	$ 7,944	$ -	$ -	$ 7,944
Commodity contracts	-	27	-	27
Other receivable	27,391	-	-	27,391
Financial Liabilities				
Bank indebtedness	-	-	2,122	2,122
Accounts payable and accrued liabilities	-	-	7,859	7,859
Long-term debt	-	-	4,992	4,992
Preferred shares	-	-	11,192	11,192

g) Fair values

The fair values of the Company's accounts receivable, 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 Industrial Technologies Office, which is a governmental body, is due within one year, and management believes that any future debt would come from related parties. The remaining long-term debt is in the form of finance leases which will be re-paid within three years, and fair value is not materially different from the value recorded.

8. Fair Value Measurement

The following table provides the fair value measurement hierarchy of the Company's financial assets and liabilities.

				December 31, 2013
	Total	**Quoted prices in active markets (Level 1)**	**Significant observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets measured at fair value:				
Accounts receivable	$ 8,845	$ -	$ -	$ 8,845
Commodity contracts	25	-	-	25
Liabilities measured at fair value:				
Accounts payable and accrued liabilities	7,645	-	-	7,645
Long-term debt	266	-	-	266
Preferred shares	36	-	-	36

9. Accounts Receivable

FOR THE YEAR ENDED DECEMBER 31	**2013**	2012
Trade receivables	**$ 8,505**	$ 6,926
Input tax credits	**166**	940
Accrued receivables	**174**	78
	8,845	7,944

(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 accrued receivables are denominated in the following currencies:

FOR THE YEAR ENDED DECEMBER 31	2013	2012
US dollar	**US $ 4,750**	US $ 2,934
Canadian dollar	**3,793**	5,026

10. Inventories

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Raw materials	**$ 5,005**	$ 7,418
Work-in-progress	**9,203**	8,478
Finished products	**732**	676
	14,940	16,572

The amount of inventory expensed in cost of sales during the year ended December 31, 2013 amounted to $60,750,000 (December 31, 2012: $68,979,000). The carrying value of inventory pledged as security as at December 31, 2013 is $14,940,000 (December 31, 2012: $16,572,000).

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, 2013 provision for anticipated losses was $51,000 (December 31, 2012: $Nil). Work in progress inventory noted in the above table has been presented net of these provisions for anticipated losses. Certain program inventories have been funded by a customer, whereby the associated deferred program revenues will be recorded as revenue upon delivery of units of production.

11. Other Receivable

On November 16, 2012, the Company received the determination of an appointed arbitration panel constituted to adjudicate outstanding issues relating to cost reimbursements and compensation payable to the Company in connection with the transition of Cessna Aircraft Company ("Cessna") production work back to Cessna and other suppliers. The quantum of damages was assessed by the arbitration panel in 2012 at US$27,391,000.

On November 26, 2012 Cessna filed a complaint in the United States District Court For The District Of Kansas (the "District Court"), seeking to vacate the award as a manifest disregard for the law and in violation of public policy.

The Company received a Memorandum and Order of the United States District Court for the District of Kansas, which heard the motion by Cessna to vacate the arbitration award made on November 16, 2012, in favour of the Company in the amount of US$27,391,000. Cessna's motion to vacate was denied and the District Court affirmed the award to the Company. In addition, the District Court awarded post-award prejudgment interest at a rate of 10% per annum from December 16, 2012 to the date of the order. This prejudgment interest award totaled approximately US$1,073,000. The District Court entered final judgment against Cessna in the amount of approximately US$28,464,000 on May 8, 2013. A Notice of Appeal and a Motion to Stay Execution was filed by Cessna on June 7, 2013 in the United States Court of Appeals for the Tenth Circuit.

On September 5, 2013 the Company entered into a settlement agreement, from a court directed mediation with Cessna, which settled all outstanding litigation between the Company and Cessna. The settlement required payment by Cessna of US$27,964,000 ($29,380,000) in satisfaction of the judgement entered against Cessna from the arbitration award made on November 16, 2012, resulting in US$573,000 ($604,000) recorded as additional award settlement for 2013. The settlement funds were received in full by the Company on September 6, 2013. This settlement satisfies the judgement and has resulted in the dismissal of the outstanding appeal.

12. Development Costs

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

(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	**2013**	2012
Opening balance	**$ 2,718**	$ 5,540
Additions	**556**	1,071
Realized and amortization	**(2,034)**	(3,893)
	1,240	2,718

FOR THE YEAR ENDED DECEMBER 31	**2013**	2012
Cost	**$ 4,209**	$ 3,669
Accumulated amortization	**(2,969)**	(951)
Net book amount	**1,240**	2,718

Customers have funded non-recurring costs incurred during the introduction of new production programs. These costs are deferred as development costs and will be amortized to income in conjunction with the associated revenue upon commencement of production, straight-line over the contract period; or on a units-of-production basis over the expected life of the programs.

13. Property, Plant and Equipment

	Machinery and equipment	**Computer hardware and software**	**Leasehold improvements**	**Total**
Year ended December 31, 2012				
Opening net book amount	10,572	1,403	548	12,523
Additions	160	584	33	777
Disposals – cost	(7,349)	(1,871)	-	(9,220)
Disposals – accumulated depreciation	6,715	1,850	-	8,565
Depreciation charge	(2,480)	(447)	(85)	(3,012)
Closing net book amount	7,618	1,519	496	9,633
At December 31, 2012				
Cost	28,998	6,747	914	36,659
Accumulated depreciation	(21,380)	(5,228)	(418)	(27,026)
Net book amount	7,618	1,519	496	9,633
Year ended December 31, 2013				
Opening net book amount	7,618	1,519	496	9,633
Additions	506	670	30	1,206
Disposals – cost	(1,074)	(18)	-	(1,092)
Disposals – accumulated depreciation	1,021	18	-	1,039
Depreciation charge	(1,444)	(550)	(88)	(2,082)
Closing net book amount	6,627	1,639	438	8,704
At December 31, 2013				
Cost	29,319	7,399	944	37,662
Accumulated depreciation	(22,692)	(5,760)	(506)	(28,958)
Net book amount	6,627	1,639	438	8,704

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

Included in computer hardware and software are assets held under finance leases at a cost of $220,000 (December 31, 2012: $261,000) having accumulated depreciation of $91,000 (December 31, 2012: $57,000).

Included in machinery and equipment are assets held under finance leases at a cost of $Nil (December 31, 2012: $55,000) having accumulated depreciation of $Nil (December 31, 2012: $43,000).

Certain machinery, equipment and tooling, which were written down to $Nil net book value in a previous year, were disposed of during the year for consideration of $108,000. The equipment which was no longer in use had a cost of $888,000 and an accumulated depreciation of $888,000.

During 2013, the value of certain machinery, equipment and tooling was written down by $53,000 (December 31, 2012: $655,000). The equipment which was no longer in use had a cost of $186,000 (December 31, 2012: $9,220,000), and an accumulated depreciation of $133,000 (December 31, 2012: $8,565,000); resulting in a $53,000 charge against income.

The Company has $357,000USD in commitments at year-end to purchase property, plant and equipment in 2014.

14. Bank Indebtedness

On September 27, 2012 the Company entered into a loan agreement with a Canadian chartered bank for a $12 million principal amount secured debt facility. The debt facility has a three-year term and bears interest at a rate equal to the bank's prime rate plus 0.5%.

The debt facility is secured by a charge and specific registration over all of the assets of the Company.

As a condition of obtaining this operating line of credit, the following terms were established:

- Company shall maintain a consolidated fixed charge coverage ratio of not less than 1:1, calculated on a rolling twelve month basis and tested as of the end of each fiscal month;
- Company shall maintain excess availability on its operating line of credit in an amount no less than a cure amount providing for any shortfall in the fixed charge coverage ratio; and
- the cure amount can only be added to the numerator two times in the 2014 fiscal year and thereafter.

As at December 31, 2013, the consolidated fixed charge coverage ratio was measured at 0.79:1 for which the Bank instituted a cure for the period.

As at December 31, 2013 the Company had drawn $Nil (December 31, 2012: $2,122,000) on this debt facility offset by $7,012,000 cash (December 31, 2012: $2,597,000 cash), providing a net cash position of $7,012,000 (December 31, 2012: $475,000 cash).

15. Accounts Payable and Accrued Liabilities

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Trade payables	**$ 3,543**	$ 3,954
Payroll-related liabilities	**3,238**	3,154
Other	**864**	751
	7,645	7,859

16. Deferred Program Revenues

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Opening balance	**$ 17,514**	$ 18,671
Additions	**15,441**	15,015
Realized	**(22,945)**	(16,172)
	10,010	17,514

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

Certain program inventories have been funded by a customer, whereby the associated deferred program revenues will be recognized as revenue upon delivery of units of production.

Additionally, customers have funded non-recurring costs incurred during the introduction of new production programs. These costs are deferred as development costs and will be amortized to income, straight-line over the contract period; or on a units-of-production basis over the expected life of the programs, in conjunction with the associated deferred revenue upon commencement of production.

The Company has amended its accounting with respect to the classification of deferred program revenues in its 2013 consolidated financial statements. Previously, all of the Company's deferred program revenues were classified as non-current. Deferred program revenues will now be classified as current or non-current based on the estimated timing of when the related revenue will be recognized. As a result, deferred program revenues as at December 31, 2012 in the amount of $17,514,000 has been reclassified from non-current to current. The impact as of January 1, 2012 has not been estimated as it is impracticable to determine what management would have estimated as of January 1, 2012 without undue application of hindsight.

As a result of the reclassification of deferred program revenues, 2012 cash inflows of $9,712,000 have been reclassified from financing activities to operating activities, to reflect the nature of the deferred revenue balance which has generated the cash flows.

17. 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 $216,000 as at December 31, 2013 (December 31, 2012: $263,000). The amount of prepaid rent the Company has as at December 31, 2013 is $146,000 (December 31, 2012: $146,000).

Concurrent with the 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 $469,000 as at December 31, 2013 (December 31, 2012: $567,000).

18. Long-Term Debt

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Convertible debenture (a)	$ -	$ 4,392
Finance leases (b)	132	208
Accrued government royalties (c)	134	392
	266	4,992
Less: Current portion	(199)	(692)
	67	4,300

a) Export Development Canada Convertible Debenture

On October 15, 2013, the Company repaid in full the Export Development Canada convertible debenture. The principal amount repaid was $4,038,000. Accrued interest amounting to $7,000 was also repaid. The debenture has been extinguished and no further amounts are owed.

b) Finance Leases

There are various equipment leases that have a weighted average interest rate of 8.30% 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.

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

c) Accrued Government Royalties

Royalties of $134,000 (December 31, 2012: $392,000) applicable on certain contracts are payable to Industrial Technologies Office. This balance is due on April 30, 2014.

19. 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:

FOR THE YEAR ENDED DECEMBER 31	**2013**		2012	
	Operating	**Finance**	Operating	Finance
2013	**$ -**	**$ -**	$ 2,504	$ 97
2014	**2,706**	**75**	2,497	75
2015	**2,723**	**59**	2,398	67
2016	**2,622**	**12**	2,412	-
2017	**2,622**	**-**	2,412	-
2018	**1,459**	**-**	1,354	-
Thereafter	**420**	**-**	420	-
Total future minimum lease payments	**12,552**	**146**	13,997	239
Less: Imputed interest	**n/a**	**(14)**	n/a	(31)
Balance of obligation under finance leases included in long-term debt (note 18b)	**n/a**	**132**	-	208

For the year ended December 31, 2013, an amount of $2,671,000 representing payments under operating leases was expensed (December 31, 2012: $2,507,000).

As at December 31, 2013 the Company had $12,634,000 of committed contractual operational purchase order obligations outstanding (December 31, 2012: $14,883,000).

20. Capital Stock

Authorized

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

Common shares issued or reserved:

	Number of shares	**Amount**
December 31, 2011	201,994,113	$ 73,251
Share issue		
Cash (i)	23,172,552	973
Non-cash (c,d,e,f,g,h)	29,731,407	1,993
Loan Conversion	-	206
December 31, 2012	254,898,072	76,423
Share issue		
Cash (a)	25,489,807	1,249
Non-cash (b)	3,273	9
December 31, 2013	280,391,152	77,681

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

a) On May 9, 2013, the Company completed a private placement of 25,489,807 common shares at $0.049 per share for gross proceeds of approximately $1,249,000. The subscriber in the private placement was Panta Canada B.V., which owns 64.4% of the Company's common shares as at December 31, 2013. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

b) On August 12, 2013, a holder of preferred shares converted 900 preferred shares resulting in the issuance of 3,273 common shares at $2.75 per share for a book value of $9,000.

c) On January 10, 2012, the Company completed a private placement of 1,173,126 common shares in consideration of $55,000 interest accrued for the period from July 1, 2011 to September 30, 2011 on the Export Development Canada convertible debenture (note 18a).

d) On February 6, 2012, the Company completed a private placement of 1,150,395 common shares in consideration of $55,000 interest accrued for the period from October 1, 2011 to December 31, 2011 on the Export Development Canada convertible debenture (note 18a).

e) On April 4, 2012, the Company completed a private placement of 107,575 common shares in consideration of a $4,000 payment to the former principal shareholders of Comtek Advanced Structures Ltd., under the terms of a Share Purchase Agreement.

f) On April 20, 2012, the Company completed a private placement of 1,008,142 common shares in consideration of $54,000 interest accrued for the period from January 1, 2012 to March 31, 2012 on the Export Development Canada convertible debenture (note 18a).

g) On September 21, 2012, the Company completed a private placement of 992,169 common shares in consideration of $54,000 interest accrued for the period from April 1, 2012 to June 30, 2012 on the Export Development Canada convertible debenture (note 18a).

h) On September 27, 2012, the Company issued 25,300,000 common shares at $0.07 per share for a book value of $1,771,000, pursuant to the terms of a loan agreement entered into between the Company and Panta Canada B.V. on April 16, 2010. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

i) On September 28, 2012, the Company completed a private placement of 23,172,552 common shares at $0.042 per share for gross proceeds of approximately $973,000. The subscriber in the private placement was Panta Canada B.V. Panta Canada B.V. is 100% owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

j) The Company's incentive stock option plan is administered by the Board of Directors. It is a rolling share option plan wherein 10% of the issued and outstanding common shares at the time an option is granted are reserved for issuance.

A summary of the Company's stock options issued as of December 31, 2013 and December 31, 2012, and changes during the periods ending on those dates, are presented below.

FOR THE YEAR ENDED DECEMBER 31	**2013**		2012	
	Options	**Weighted average exercise price**	Options	Weighted average exercise price
Outstanding – Beginning of year	**11,266,000**	**$ 0.05**	8,035,500	$ 0.05
Granted	**-**	**-**	3,230,500	0.05
Forfeited	**(730,500)**	**0.05**	-	-
Exercised	**-**	**-**	-	-
Outstanding – End of year	**10,535,500**	**0.05**	11,266,000	0.05

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

The following table summarizes stock options outstanding and exercisable as at December 31, 2013:

	Number	Weighted average remaining contractual life (years)	Weighted average exercise price
$0.05 - $0.06	10,535,500	1.98	$ 0.05

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

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Beginning of year	**$ 3,539**	$ 3,424
Stock-based compensation expense	**54**	115
Fair value of warrants	**-**	-
End of year	**3,593**	3,539

l) During 2011 19,550,532 warrants were issued having a fair value of $617,000. Each warrant is exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share.

21. Preferred Shares

On July 10, 2006, the Company issued 1,200,000 Series A First Preferred Shares (the "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 and charged against equity. The amount of issuance costs has been reflected within preferred shares upon redemption. The comparative December 31, 2012 preferred shares liability and corresponding deficit balance within equity as disclosed on the Consolidated Statement of Financial Position have been reclassified by $546,000 to present the gross proceeds payable at that time.

The preferred shares provided for a 9.25% per annum dividend, payable quarterly in cash on the last day of March, June, September and December.

During 2013, the Company filed a notice of redemption for its preferred shares notifying preferred shareholders that the preferred shares together with all dividends accrued thereon were to be paid on November 14, 2013, upon receipt of original Series A First Preferred Share Certificates at the registered offices of the Company. Preferred shares amounting to $8,134,000 along with $3,669,000 accrued dividends thereon were paid during the fourth quarter 2013. $25,000 preferred shares and $11,000 of accrued dividends remain unpaid as at the reporting date (note 31b).

22. Stock Based Compensation

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

No options were granted during the year ended December 31, 2013.

The amount of stock-based compensation expense, for options granted in prior periods, amortized to earnings during the year ended December 31, 2013 was $54,000 (2012: $115,000).

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.

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

23. 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	2013	2012
Defined contribution plan	$ 1,403	$ 1,447

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.

24. Finance Costs

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Interest on capital leases	$ 15	$ 37
Interest on other long-term debt	167	306
Interest on short-term debt	88	71
Interest on related party debt	-	747
Preferred share dividends accrued	657	756
Accretion of equity component of convertible loan	-	67
Accretion of fair value of warrants	-	132
Net interest expense	927	2,116

25. Supplementary Cash Flow Information

Non-cash financing and investing activities:

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Conversion of preferred shares	$ 9	$ -
Debt and interest paid using common shares	-	1,993
Equipment acquired under capital lease	-	220
Equity component of convertible loan	-	247
Uncollected deferred tooling revenue	2,759	706

26. Warranty Provisions

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Opening balance	$ 85	$ 85
Charge/(credit) to the statement of income:		
Additions	-	-
Increases(decreases) to existing provisions	(85)	-
Accretion	-	-
Used during year	-	-
	-	85

During 2010, the Company provided for $428,000 of expected warranty expenditures relating to a manufacturing deficiency. All rectifications have been completed by the date of this report, and $Nil 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)

27. Income Tax

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

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Statutory tax rate	**25.75%**	25.0%
Income tax (recovery) expense at the statutory income tax rate	**(464)**	$ 5,161
Adjustment of provision to tax return	**(191)**	211
Change in unrecognized deferred tax assets	**936**	551
Benefit of losses not previously recognized	**(477)**	(6,286)
Non-deductible preferred share dividends	**169**	188
Other	**27**	175
Tax expense	**-**	-

The provision for income tax (recovery) expense is based on the combined federal and provincial annual income tax rate expected for the full financial year of 25.75%. The tax rate has increased by 0.75% from December 31, 2012 due to a provincial corporate tax rate increase.

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 $14,650,000 (2012: $14,823,000) in respect of losses amounting to $20,276,000 (2012: $21,310,000) which expire beginning in 2015 through 2033, unclaimed research and development costs of $10,830,000 (2012: $10,421,000) with no expiry, and investment tax credits of $1,597,000 (2012: $3,057,000) which expire beginning in 2016 through 2032, and deductible temporary differences of $20,252,000 (2012: $18,221,000).

28. Related Party Transactions

a) During the current year a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. who's wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 64.4% of the issued and outstanding common shares on December 31, 2013. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the year ended December 31, 2013 amounted to $690,000 (December 31, 2012: $38,000). Fees payable to Panta Holdings B.V. as at December 31, 2013 are $170,000 (December 31, 2012: $17,000). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $843,000 for the year ended December 31, 2013 (December 31, 2012: $55,000).

b) During the year ended December 31, 2013, 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, 2013 amounted to $81,000 (December 31, 2012: $62,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2013 are $Nil (December 31, 2012: $14,000). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $67,000 for the year ended December 31, 2013 (December 31, 2012: $76,000).

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.

(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	2013	2012
Salaries and other short-term employee benefits	**$ 809**	$ 751
Contributions to defined contribution plan	**41**	39
Option-based awards	**4**	12
	854	802

d) Loans to related parties

The balance of loans receivable from key management as at December 31, 2013 is $15,000 (December 31, 2012: $15,000).

Other related-party transactions are disclosed elsewhere in these consolidated financial statements (notes 20a, h and i).

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

29. Earnings per share

Basic earnings per share amounts are calculated by dividing the net income for the year attributable to common equity holders of the parent by the weighted average number of common shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to common equity holders of the parent (after adjusting for dividends on the convertible preferred shares and interest on the convertible debenture) by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on conversion of all the dilutive potential common shares into common shares. During 2013 dividends on the convertible preferred shares and interest on the convertible debenture are anti-dilutive, and therefore are not included in the calculation of diluted earnings.

The following reflects the share data used in the basic and diluted earnings per share computations:

FOR THE YEAR ENDED DECEMBER 31	2013	2012
Weighted average number of common shares for basic earnings per share	**271,380**	217,775
Effect of dilution:		
Share options	**-**	309
Weighted average number of ordinary shares adjusted for the effect of dilution	**271,380**	218,084

There have been transactions involving common shares or potential common shares between the reporting date and the date of authorization of these consolidated financial statements (note 31a).

30. Economic Dependence and Segmented Information

a) Sales to major customers for the year ended December 31, 2013, which comprise several programs and contracts, accounted for approximately 86.3% (December 31, 2012: 85.0%) of sales.

FOR THE YEAR ENDED DECEMBER 31	2013		2012	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$ 22,604**	**29.2**	$ 15,193	17.0
Boeing	**28,167**	**36.4**	29,961	33.6
Bombardier	**16,370**	**21.2**	16,784	18.8
Cessna	**-**	**-**	14,055	15.7
Other	**10,223**	**13.2**	13,344	14.9
Total	**77,364**	**100.0**	89,337	100.0

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

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 and repairs. Avcorp Industries Inc. is located in British Columbia and is dedicated to light weight metal manufacturing and assembly. Revenues, income (loss) and total assets are distributed by operating segment as noted in the tables below.

FOR THE YEAR ENDED DECEMBER 31	**2013**		2012	
	Revenue	**% of Total**	Revenue	% of Total
Avcorp Industries Inc.	**$ 66,707**	**86.2**	$75,543	84.6
Comtek Advanced Structures Ltd.	**10,657**	**13.8**	13,794	15.4
Total	**77,364**	**100.0**	89,337	100.0

FOR THE YEAR ENDED DECEMBER 31	**2013**		2012	
	(Loss) Income	**% of Total**	(Loss) Income	% of Total
Avcorp Industries Inc.	**$ (834)**	**46.3**	$ 20,826	100.0
Comtek Advanced Structures Ltd.	**(968)**	**53.7**	(185)	0.0
Total	**(1,802)**	**100.0**	20,641	100.0

FOR THE YEAR ENDED DECEMBER 31		**2013**		2012
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$ 37,947**	**89.9**	$ 64,110	93.4
Comtek Advanced Structures Ltd.	**4,246**	**10.1**	4,525	6.6
Total	**42,193**	**100.0**	68,635	100.0

31. Subsequent events

a) Subsequent to the end of the year, holders of the Company's stock options exercised 1,961,000 stock options resulting in the issuance of 1,961,000 common shares with a value of $98,000.

b) Subsequent to the end of the year the remaining $25,000 preferred shares and $11,000 of accrued dividends were paid.

notes

AVCORP INDUSTRIES INC.

BOARD OF DIRECTORS AND OFFICERS

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

Jaap Rosen Jacobson (2)
DIRECTOR
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)
DIRECTOR
Chief Executive Officer
Weatherhaven
West Vancouver, British Columbia

Kees de Koning (3)
DIRECTOR
Nootdorp, The Netherlands

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

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

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

* Designates the Committee Chair

MANAGEMENT

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

Larry Glenesk
Senior Vice President, Business Development
White Rock, British Columbia

Amandeep Kaler
Senior Vice President, Supply Chain Management & Operations
Surrey, British Columbia

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

Jeff Schoenfeld
Vice President, Engineering & Development
Vancouver, British Columbia

Paul Wiggum
Vice President, Sales & Marketing
White Rock, British Columbia

DIRECTORY

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

Ernst & Young LLP
Chartered Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Registrar and Transfer Agent

CST Trust Company
Vancouver, British Columbia

Bank

Royal Bank of Canada
Richmond, British Columbia

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