AVCORP

annual report 2009

ABOUT AVCORP INDUSTRIES INC. Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including Boeing, Bombardier, and Cessna. With more than 50 years of experience, 473 skilled employees and 354,000 square feet of facilities, Avcorp offers integrated composite and metallic aircraft structures to aircraft manufacturers, a distinct advantage in the pursuit of contracts for new aircraft designs, which require lower-cost, light-weight, strong, reliable structures. Avcorp is a Canadian public company traded on the Toronto Stock Exchange (TSX:AVP).

management discussion & analysis

This Management Discussion and Analysis has been prepared as of March 26, 2010, and should be read in conjunction with the Company's financial statements and notes thereto for the year ended December 31, 2009.

Description of Business

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

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

Avcorp is in compliance with Industry Standard Quality requirements.

Financial Overview

Three-Year Results

The following table provides selected financial information for the three years to December 31, 2009.

THREE-YEAR RESULTS

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

For the year ended December 31	2009	2008	2007
OPERATIONS			
Revenues	$ 69,202	$ 128,868	$ 110,283
EBITDA[1]	(2,500)	6,410	4,155
Operating income (loss) before tax	(5,501)	485	205
Net income (loss)	(8,410)	(2,251)	(1,719)
Basic income (loss) per share	(0.12)	(0.07)	(0.06)
Diluted income (loss) per share	(0.12)	(0.07)	(0.06)
FINANCIAL POSITION			
Net capital expenditures	402	2,771	5,020
Total assets	48,026	60,990	60,304
Bank indebtedness and long-term debt	16,364	23,418	20,096
Shareholders' equity	16,844	16,325	18,519
Book value per share	0.09	0.51	0.59
Ratio: debt/equity	0.97	1.43	1.09
Ratio: current assets/current liabilities	1.04	0.94	1.16
Shares outstanding at period end	177,732,112	32,314,929	31,444,724

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

Quarterly Results

The following table provides selected unaudited quarterly financial information for the eight most recent fiscal quarters to December 31, 2009.

QUARTERLY RESULTS

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

	2009				2008			
For the three months ended	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	$ 16,641	$ 14,302	$ 16,172	$ 22,087	$ 34,434	$ 30,894	$ 32,389	$ 31,151
Income (loss) from operations	(1,936)	(2,128)	552	(1,989)	(1,561)	1,004	859	183
EBITDA[1,2]	(1,377)	(1,103)	1,530	(1,550)	1,141	1,676	2,218	1,375
Net income (loss)	(2,718)	(2,585)	65	(3,172)	(1,972)	(220)	364	(423)
EBITDA per share[1,2]								
Basic	(0.01)	(0.02)	0.05	(0.05)	0.04	0.05	0.07	0.04
Diluted	(0.01)	(0.02)	0.05	(0.05)	0.04	0.05	0.07	0.04
Net income (loss) per share								
Basic	(0.02)	(0.06)	0.00	(0.10)	(0.06)	(0.01)	0.01	(0.01)
Diluted	(0.02)	(0.06)	0.00	(0.10)	(0.06)	(0.01)	0.01	(0.01)
Long-term debt	1,811[3]	2,034[3]	2,387[3]	2,843[3]	2,872[3]	7,192	7,424	6,306

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

2009 and 2008 Results Overview

During the year ended December 31, 2009, the Company recorded a loss from operations of $5,501,000 on $69,202,000 revenue, as compared to $485,000 earnings from operations on $128,868,000 revenue for the preceding year; and a net loss for the current year of $8,410,000 as compared to a net loss of $2,251,000 for the year ended December 31, 2008.

It should be noted that the current year loss includes a $4,412,000 foreign exchange gain (December 31, 2008: $2,349,000 foreign exchange loss) which occurred as a result of holding foreign-currency-denominated receivables, payables and debt.

The Company incurred legal, consulting and professional investment service fees in the course of negotiating, analyzing and documenting its financial restructuring. These are one-time costs for which fees amounting to $324,000 were expensed during 2009.

Foregone deposits on equipment purchases as well as write-off of obsolete assets resulted in a $793,000 charge against income in 2009.

During 2009 the Company commenced deliveries of completed components for the Cessna Citation CJ4 business jet. Losses amounting to $425,000 were incurred by this program due to the negative impact of the labour learning curve on program start-up. However, it is important to note that these anticipated losses are less than planned levels because assembly labour hours expended to date are lower than engineered assembly hour standards.

The Company has increased its provision for loss making contracts by $515,000 during the current year, primarily as a result of introduction of the aforementioned program.

Significantly reduced customer demand, relative to the preceding year, has resulted in idle plant capacity. The Company has expensed $4,667,000 of overhead costs during the current year (year-to-date December 31, 2008: $Nil) which under prior years' production levels would have been inventoried, then expensed at a later time when the product is sold.

Additionally, the significant reductions in the plant labour force have resulted in a higher unit cost of labour due to the remaining senior employees earning a higher rate of wages and benefits. Reallocations of employees amongst programs in an effort to match customer delivery requirements have caused production inefficiencies as employees perform new tasks in different work centres. These inefficiencies will continue to exist in 2010 as customer programs which were dormant in 2009 restart. The Company has established specific program restart projects in an effort to mitigate program start-up inefficiencies. These actions include process flow improvements such as jig modifications, upgrade of manufacturing assembly planning documents, as well as balancing inventory throughout the supply chain.

The Company expects revenue growth in 2010 from full rate production of the Boeing Defense Space & Security CH47 helicopter as well as the Cessna Citation CJ4 business jet; both programs were in start-up phase for the Company in 2009.

Cash flows from operating activities during the current year utilized $2,002,000 of cash, as compared to providing $5,412,000 of cash during the year ended December 31, 2008. The Company has a working capital surplus of $820,000 as at December 31, 2009 (December 31, 2008: $2,065,000 deficit) and an accumulated deficit of $65,379,000 at December 31, 2009 (December 31, 2008: $56,213,000).

The Company has operating lines of credit with a Canadian chartered bank totalling $15,000,000 (December 31, 2008: $17,000,000). The facilities are due on demand.

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

- general security agreement creating a first priority security interest in all present and after-acquired personal property of the Company and a floating charge over all of the Company's present and after-acquired real property;
- assignment/endorsements by the Company to the Bank of all risk insurance on all of the Company's real and personal property with the Bank as first loss payee;
- the credit available to the Company under its operating lines of credit shall be equal to the amount determined by the margin formula currently in place less $1,000,000 until such time as an equivalent amount is guaranteed by a party acceptable to the bank;
- interest at Bank prime plus 3.0%; and
- the Company shall pay the Bank a monthly forbearance fee of $10,000;

The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage. As at December 31, 2009, the Company was not in compliance with a financial covenant. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment.

On August 12, 2009, the Company entered into a Forbearance Agreement with the bank providing its operating lines of credit. The Forbearance Agreement ended on November 10, 2009. The Company is subject to a quarterly review within which the Bank determines if there has occurred an event of default. Provided no default has occurred, the Forbearance Agreement is extended for a recurring period of 90 days. The Bank has completed a follow-on Forbearance Agreement as at March 11, 2010 which expires on June 9, 2010.

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

- On July 21, 2009, the Company issued 16,157,465 common shares to Panta Holdings B.V. at $0.15 per share providing gross proceeds of $2,423,000. The Company received aggregate net proceeds of $858,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V.;
- On October 7, 2009, the Company completed a rights offering within which 129,259,718 common shares were issued at $0.06 per share providing gross proceeds of $7,755,000. The Company received aggregate net proceeds of $4,386,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V.; and
- The costs of issuing capital stock during 2009 amounted to $493,000 and were deducted from total proceeds of $10,178,000 to record $9,685,000 as capital stock.

On March 1, 2010, the Company completed a private placement of 17,773,211 common shares at $0.055 per share for gross proceeds of approximately $978,000. Subscribers in the private placement are Panta Holdings B.V., which has subscribed for 15,995,890 common shares, and Working Opportunity Fund (EVCC) Ltd., which has subscribed for 1,777,321 common shares. The common shares issued under the private placement are subject to a restriction on resale for a period of four months and one day from the date of issue, in accordance with applicable Canadian securities laws.

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

The Company has completed the following actions to provide liquidity for its operations:

- Reduced its employee base by 266 staff and plant workers since December 31, 2008 (36% reduction). This employee base is sufficient for the current level of sustaining operations.
- Salary reductions for all staff and management.
- Deferred procured material receipts to levels supporting decreased production rates.
- All discretionary spending on goods and services has been eliminated.
- Postponed receipt of equipment.
- Obtained debt and equity to provide working capital financing.
- Negotiated settlement of amounts owed and renegotiated supplier payment terms.
- Postponed royalty payments over an extended period with Industrial Technologies office.

The Company is currently working on the completion of obtaining additional debt and equity to provide working capital financing for anticipated growth in revenues in 2010.

Going Concern

As at December 31, 2009, the Company was not in compliance with a financial covenant associated with its operating lines of credit. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment. The lender had agreed to forbear from demanding payment of the indebtedness and from taking steps to enforce the security subject to the Company complying with terms and conditions of a Forbearance Agreement which ended on November 10, 2009. On March 11, 2010, the Company and the Bank entered into a follow-on Forbearance Agreement which will expire on June 9, 2010.

Also, as at December 31, 2009, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada. The Company has obtained a waiver from the debenture holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such future breaches, the lender would be entitled to demand payment. Accordingly, the convertible debenture is classified as current debt. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage. Provided no default has occurred, the Company will not be obligated to pay any interest or principal until the debenture matures on March 31, 2011. The debenture bears interest at 5.0% per annum and is unsecured.

During June 2009, the Company's Board of Directors resolved to defer Preferred Share dividends until January 2011. The Company has not paid $756,000 of preferred share dividends which were accrued and payable as at December 31, 2009.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The conditions and risks noted above cast significant doubt on the validity of that assumption. The Company forecasts its financing requirements in the next 12 months to exceed the current availability of the operating line of credit. Accordingly, the Company has completed a private placement and rights offering, and will continue its efforts to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and maintain existing terms regarding customer collections in order to provide liquidity in excess of forecasted requirements. However, the success of these activities cannot be assured.

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

Revenue

Revenue for the year ended December 31, 2009 was $69,202,000 as compared to $128,868,000 for 2008. Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

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

For the year ended December 31	2009		2008	
	Revenue	% of Total	Revenue	% of Total
Boeing	$ 23,493	33.9	$ 18,518	14.4
Bombardier	17,681	25.6	28,760	22.3
Cessna	15,419	22.3	64,710	50.2
Other	12,609	18.2	16,880	13.1
Total	69,202	100.0	128,868	100.0

Shipments of large assemblies to Boeing Commercial Airplane Group (Boeing), specifically for the 737 commercial jet program increased by 13% during 2009 relative to 2008. The primary source of revenue from Boeing is from the 737 aircraft. Furthermore, Boeing's programs which were introduced into production over the course of 2008 reached full rate production in 2009 and consequently produced higher revenues during the current year in comparison to the prior year. During the second quarter 2009 the Company commenced delivering components to Boeing Defense, Space & Security for the Chinook CH47 helicopter. The Company achieved full rates of production parts for this program during 2009, with the intent to deliver larger assembled structures in 2011. The Company continues to work towards obtaining additional new contracts supporting Boeing commercial jet programs.

Deliveries to Bombardier Aerospace (Bombardier) decreased for the Challenger CL605 and CL850 business jet programs during the current year relative to the year ended December 31, 2008. Customer demand for these structures was 44% lower during the current year in comparison to the previous year. The Company's primary source of revenues from Bombardier in 2010 will continue to be from components on the CL605 and CL850 business jets, and composite floor boards for the CRJ and Q400 aircraft programs.

Deliveries of major structures to Cessna were 76% lower during 2009, relative to 2008. The reduction in deliveries was precipitated by a reduction in aircraft deliveries by Cessna as well as a burn-off of inventories by this customer. The primary sources of revenue from Cessna are from deliveries of components for the Citation Sovereign business jet, the Citation CJ3 business jet and the Citation CJ4 business jet. A continuation of deliveries for components of these aircraft is expected to comprise the majority of revenues from Cessna for 2010. Citation CJ3 component deliveries are expected to further decrease, while deliveries of Citation Sovereign components are expected to increase significantly in 2010. The first deliveries for the Citation CJ4 business jet components commenced during 2009 and are expected to increase substantially in 2010.

Deliveries of Boeing 757 commercial jets wing adapter plugs for winglet retrofit to Aviation Partners Boeing have fallen by 33% relative to the year-ended December 31, 2008. This is as a result of decreased demand for aircraft retrofits by airlines.

Revenues for Comtek Advanced Structures Ltd. (Comtek) decreased by approximately 19% during 2009 relative to 2008. The reduction in revenue was primarily attributable to the cessation in deliveries of composite structures to a tier-one supplier for the Airbus 380, with final deliveries expected during the first quarter 2010. The termination of the contract by the tier-one supplier has resulted in a reduction in order backlog in excess of $4,000,000.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2009 was 6.7% of revenue as compared to 16.8% of revenue for the year ended December 31, 2008.

Gross profit has declined during the current year, relative to the immediately preceding year, because reduced revenues resulting from a rapid reduction in customer demand during 2009 has had an adverse impact on the Company's cost structure.

Overhead costs incurred in support of operational capabilities, as well as quality and engineering systems expenditures, have become increasingly significant relative to the revenues the business is generating. Costs expensed as a result of idle plant capacity amounted to $4,667,000 during the year. This cost-revenue imbalance can be partially mitigated in 2010 by new program revenue growth, which should occur with full rate production for the Citation CJ4 business jet components and full year delivery of components to Boeing Defense, Space & Security for the CH47 helicopter.

During the current year, losses amounting to $425,000 were incurred by the Citation CJ4 business jet program due to the negative impact of the labour learning curve on program start-up. However, it is important to note that these anticipated losses are less than planned levels because assembly labour hours expended to date are lower than engineered assembly hour standards.

The Company has increased its provision for loss making contracts by $515,000 during the current year, primarily as a result of introduction of the Citation CJ4 business jet program during 2009.

As the workforce has been reduced, the remaining employees are relatively senior in pay-grade and consequently the average wage and benefit rate the Company pays has increased. The cost of materials used in production has remained relatively constant.

A re-tooling of plant-floor processes as well as anticipated new program revenue growth will be the largest factors in reducing the Company's cost structure and contributing towards offsetting idle capacity costs.

Administration and General Expenses

As a percentage of revenue, administration and general expenses increased from 10.6% for the year ended December 31, 2008 to 15.1% for 2009. However, in absolute terms the administrative and general expenses were reduced by $3,199,000 for the year ended December 31, 2009 relative to last year. The Company incurred legal, consulting and professional investment service fees in the course of negotiating, analyzing and documenting its financial restructuring. These are one-time costs for which fees amounting to $324,000 were expensed during 2009.

Foreign Exchange Gain

The Company recorded a $4,412,000 foreign exchange gain during 2009 (December 31, 2008: $2,349,000 loss) as a result of holding foreign-currency-denominated receivables, payables and debt.

Other Income

The Company uses derivative financial instruments to reduce its exposure to foreign currency and price risk associated with its revenues and costs of certain procured items. A $4,000 gain arose during the year ended December 31, 2009, as a result of holding purchase and sales contracts having embedded derivatives (December 31, 2008: $36,000 loss); while a $1,000 loss occurred during 2009 (December 31, 2008: $Nil) as a result of derivative financial instruments associated with its procurement contracts. During 2008, the Company entered into USD25,000,000 of foreign-exchange-forward contracts which were executed during 2009, with the provider of its operating lines of credit. No such instruments were in place as at December 31, 2009. The Company has recorded a $708,000 derivative loss during the year-ended December 31, 2009 (December 31, 2008: $538,000 unrealized derivative gains).

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

Earnings Before Interest, Taxes, Depreciation & Amortization

Earnings before interest, taxes, depreciation and amortization (EBITDA) was a $2,500,000 loss for the year ended December 31, 2009 compared to a positive EBITDA of $6,410,000 for the year ended December 31, 2008.

EBITDA

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

For the year ended December 31	2009	2008
Income (loss) for the period	$ (8,410)	$ (2,251)
Interest expense and financing charges	1,739	2,479
Income tax expense	-	-
Depreciation	3,747	4,133
Amortization of development costs and intangible assets	424	2,049
	(2,500)	6,410

EBITDA is a term that does not have a standardized meaning under Canadian generally accepted accounting principles (GAAP). EBITDA has not been adjusted for the $4,412,000 foreign exchange gain (December 31, 2008: $2,349,000 loss), which if adjusted would result in an EBITDA loss of $6,912,000 for 2009 (December 31, 2008: $8,759,000 gain).

Interest and Financing Charges

Total interest and financing charges on both short- and long-term debt, some to related parties, for the year ended December 31, 2009 was $1,739,000 as compared to $2,479,000 for the previous year and a reduction in royalty charges. The reduction in interest and financing charges for 2009 is primarily as a result of having reduced debt over the course of 2009 and a reduction in royalty charges as a consequence of decreased revenues.

Write-Down of Assets No Longer in Use

Foregone deposits on equipment purchases as well as write-off of obsolete assets resulted in a $793,000 charge against income in 2009.

Income Taxes

The Company recorded a $328,000 future income tax recovery during 2009 as a result of the tax impact arising from amortization of intangible assets and property, plant and equipment (December 31, 2008: $Nil).

Income

Loss for the year ended December 31, 2009 was $8,410,000 compared to $2,251,000 for the year ended December 31, 2008. A $4,412,000 foreign exchange gain was offset by the adverse impact of significantly reduced revenues and resultant gross margin deterioration; specifically a $4,667,000 charge against income for idle capacity and charges amounting to $793,000 for obsolete assets and foregone deposits.

Liquidity and Capital Resources

The Company ended the current year with bank operating line utilization of $8,422,000 compared to $14,273,000 as at December 31, 2008. Unless secured by cash, the Company's operating lines of credit provide for a total utilization of $15,000,000. On closing of the October 7, 2009 rights offering the operating line of credit guarantee provided by the former Chairman of the Board and shareholder was reduced by $1,000,000 thereby having the effect of reducing the Company's operating line of credit to $14,000,000 subject to asset margining stipulations.

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

Cash Flows from Operating Activities

Cash utilized by operating activities, before consideration of changes in non-cash items relating to operating activities, was $2,002,000 for the year ended December 31, 2009 compared to cash provided of $5,412,000 for last year. This current year cash utilization occurred as a result of operating losses.

Non-cash operating assets and liabilities provided $509,000 of cash during the current year, compared to utilizing $589,000 in 2008. The 2009 balance arose primarily as a result of a consumption of inventories and collection of accounts receivable offset by payments to trade suppliers. The Company continues to closely monitor accounts receivable in order to ensure cash is collected on a timely basis.

Cash Flows from Investing Activities

During the current year, the Company purchased capital assets totaling $402,000 as compared to $2,771,000 during the year ended December 31, 2008. The Company has significantly reduced its capital expenditures in order to conserve cash with only operation critical expenditures being made.

Additionally, the Company invested $2,586,000 during the current year (December 31, 2008: $2,766,000) in tooling and in improving the production efficiencies of various program lines. A significant portion of this year's expenditure was specifically invested in new product introduction for the Cessna Citation CJ4 business jet program, and the Boeing Defense, Space & Security CH47 helicopter program, both programs for which the Company commenced delivering tail assemblies and components in the second quarter 2009. The Company also commenced investment in the joint strike fighter F35 military jet aircraft program with BAE Systems during 2009.

Cash Flows from Financing Activities

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

During the year ended December 31, 2009, the Company's operating line of credit utilization decreased by $5,851,000 (December 31, 2008: $2,994,000 increased utilization).

During the current year the Company received $400,000 from the former Chairman of the Board and shareholder in the form of a demand loan and $1,552,000 from Panta Holdings B.V. in the form of a bridge loan, both of which were repaid from proceeds of the July 21, 2009 issue of common shares. As well as, $4,000,000 from Panta Holdings B.V. in the form of a bridge loan which was repaid via the proceeds from a rights offering which closed on October 7, 2009.

For the year ended December 31, 2009, proceeds from the sale of tooling amounted to $2,309,000 (December 21, 2008: $103,000).

During the current year, the Company repaid $2,738,000 of current and long-term debt consisting of $1,321,000 in equipment financing, $260,000 in royalty repayments, $422,000 in demand loans, $689,000 in bridge loans and $46,000 of debenture interest.

On July 21, 2009, the Company issued 16,157,465 common shares at $0.15 per share providing gross proceeds of $2,423,000. The gross proceeds from this private placement were used to repay a bridge loan and accrued interest amounting to $1,565,000.

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

The Company incurred $493,000 in fees for the above-noted common share issues.

During June 2009, the Company's Board of Directors resolved to defer preferred share dividend payments until January 2011. The Company has not paid $756,000 of preferred share dividends which were accrued and payable as at December 31, 2009.

On December 31, 2009, the ratio of the Company's current assets to current liabilities was 1.04:1 (December 31, 2008: 0.94:1), with the debt to equity ratio at 0.97:1 (December 31, 2008: 1.43:1).

As at December 31, 2009, the Company was not in compliance with a financial covenant associated with its operating lines of credit. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment. The lender had agreed to forbear from demanding payment of the indebtedness and from taking steps to enforce the security subject to the Company complying with terms and conditions of a Forbearance Agreement which ended on November 10, 2009. On March 11, 2010, the Company and the Bank entered into a follow-on Forbearance Agreement which will expire on June 9, 2010.

Also, as at December 31, 2009, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada. The Company has obtained a waiver from the debenture holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such breaches, the lender would be entitled to demand payment. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage.

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	Total	2010	2011 – 2013	2014 – 2015	Post 2015
Convertible debentures	$ 4,338	$ 4,338[3]	$ -	$ -	$ -
Capital lease obligation	2,689	878	1,811	-	-
Purchase obligation[1]	22,359	2,397	7,749	5,148	7,065
Other long-term obligations[2]	915	915	-	-	-
Total contractual obligations	30,301	8,528	9,560	5,148	7,065

1 Purchase obligations include payments for the Company's operating and property leases.

2 This amount represents obligations the Company has with Industrial Technologies Office.

3 The Company will not be obligated to pay any interest or principal until the debenture matures on March 31, 2011. As at December 31, 2009, the Company was not in compliance with a financial covenant associated with the convertible debenture. The Company has obtained a waiver from the debt holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such future breach, the lender would be entitled to demand immediate payment. Accordingly, the convertible debenture is classified as current debt.

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

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

Capital Stock

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, issueable in series, the terms of which will be determined by the Company's directors at the time of creation of each series. There were 177,732,112 common shares issued and 1,141,512 reserved for issuance at December 31, 2009 pursuant to a convertible debenture. The book value of common shares issued and outstanding as at December 31, 2009 was $74,601,000.

As at March 26, 2010, there were 195,505,323 common shares, 816,800 preference shares, 450,000 warrants and no options issued and outstanding.

New Accounting Policies

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

These consolidated financial statements are prepared following accounting policies consistent with the Company's audited annual consolidated financial statements and notes thereto for the year ended December 31, 2008, except for the following changes in accounting policies. Effective January 1, 2009, the Company adopted the new Canadian Institute of Chartered Accounts (CICA) standard 3064. Adoption of the standard has not had a significant effect on these financial statements.

- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred. The adoption of this standard has not affected the Company's consolidated financial statements.

- In January 2009, the CICA approved EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity's own credit risk and the credit risk of the counter-party should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. The Company has evaluated the new section and determined that adoption of these new requirements did not have a significant impact on the Company's consolidated financial statements.

Convergence with International Financial Reporting Standards

In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted accounting principles (Canadian "GAAP"), as used by public companies, being evolved and converged with International Financial Reporting Standards ("IFRS") over a transitional period which will be complete by 2011. On February 13, 2008, the Canadian Accounting Standards Board confirmed that publicly accountable entities will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011 with appropriate comparative data from the prior year. Under IFRS, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policies that will need to be addressed by management. As of the date of this report, the International Accounting Standards Board has projects underway that should result in new pronouncements; accordingly the Company is assessing the impact of the ultimate adoption of IFRS on the Company's consolidated financial statements. Management has prepared a diagnostic identifying key areas where IFRS transition may have an impact. During the next phase of transition a technical analysis will be conducted in order to identify potential financial impacts thereby providing the platform upon which decisions on accounting policy choices will be made. Management has reviewed its business systems and determined that they are capable of processing and recording the transitional period reporting requirements. As well, key employees have been trained in the new reporting standards, and a plan for adoption of IFRS is being developed.

Recent Accounting Pronouncements

For interim and annual financial statements beginning July 1, 2011, the Company will be required to adopt CICA Handbook Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling Interests. Section 1582 replaces Section 1581, Business Combinations and Section 1601 and 1602 together replace Section 1600, Consolidated Financial Statements. The adoption of Sections 1582 and collectively 1601 and 1602 provides the Canadian equivalent to IFRS 3, Business Combinations and International Accounting Standard IAS 27, Consolidated and Separate Financial Statements, respectively. The adoption of this standard is not expected to result in a significant impact on the Company's financial statements.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2009 were at planned levels for Cessna, Bombardier and Boeing 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 extend from January 2007 to December 2011, Boeing Defense, Space and Security to December 31, 2012, and BAE systems to December 21, 2011 with the latter two agreements pending final approval by the customer and Company. The Bombardier and Cessna agreements extend for the life of the programs.

The Company defines order backlog as the value of purchase orders it expects to receive from these agreements based on manufacturers' projections and current degrees of exclusivity. The order backlog, as at December 31, 2009, was $276 million, ($68 million of which pertains to 2010), compared to $412 million as at December 31, 2008. The changes in order backlog are as follows:

- $69 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2009;
- $37 million net decrease in order backlog primarily due to production rate decreases of various existing programs; and
- $30 million decrease in order backlog resulting from changes in the value of the Canadian dollar relative to the US dollar for the Company's US dollar denominated sales. Refer to comments on currency risk.

Supply Chain

Vendor quality performance generally met targeted levels during the year, with the exception of a limited number of vendors which the Company is managing on a day-to-day basis and in some cases with on-site personnel. The Company will continue to work closely with our Supply Chain to ensure a stable, uninterrupted delivery of compliant products.

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.

Working Capital Utilization

Total current assets less total current liabilities was in a surplus position of $820,000 at December 31, 2009 and a deficit of $2,065,000 at December 31, 2008. The change in position during 2009 was primarily due to the reduction of accounts payable resulting from refinancing during the year, as well as a reduction in the Company's bank indebtedness.

Financial Resources

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

Non-Financial Resources

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

Human Resources

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

The number of employees at December 31, 2009 was 473 (December 31, 2008: 739). Employees have appropriate qualifications and experience to perform their duties and the Company provides ongoing training and opportunities for employee growth. The significant reductions in plant labour force have resulted in a higher cost of labour due to the remaining senior employees earning a higher rate of wages and benefits.

Equipment, Systems, Technologies and Processes

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

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

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

Risk Assessment

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

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

The Company's view is that with 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.

Procured Materials and Parts

Delivery delays on raw materials, in particular aluminum plate and machined components, have been partially mitigated by continued efforts with dual sourcing. In addition, continuing efforts are being undertaken to utilize customer relationships to reduce or minimize the increase in cost of bought-in materials and parts as well as ensure delivery commitments.

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

Aircraft Production Rates

The following industry and program trends impact the Company.

- Company research indicates that the aerostructures markets for commercial aircraft and business jets will be stable through 2010 following the dramatic reduction of the business jet volumes in 2009. This research also indicates some recovery in 2011. The market for defence aircraft is expected to continue to grow through 2010.
- Market indications such as recovery of air travel rates and reduced airline capacity could increase rates on the Boeing 737 and Airbus A320 in 2011.
- The production of the Boeing 757 wing adapter plug for winglet retrofits is expected to continue at its reduced rate.
- Bombardier Challenger 850 and the Challenger 605 business jet aircraft production remain flat into 2010. The rates for Bombardier's regional aircraft are expected to be at lower levels for 2010, due to generally reduced global air travel.
- Cessna Citation Sovereign and CJ3 business jet rates have decreased significantly for 2009, and it is expected that these levels will be remain for 2010. The introduction of the CJ4 is progressing as planned showing continuous growth into 2010.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exists to provide additional revenue from this aerospace sector.

Competitors

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

Cost Reductions

Approximately 56% of the Company's cost of sales is related to labour and overhead and 44% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its Western European and US competitors and higher than those in Asia, Eastern Europe and Mexico. The Company's collective agreement with its labour force, which was to expire on September 30, 2009, has been extended to March 31, 2010 with no changes in terms. Management is currently negotiating the successor agreement.

The Company continues to focus on cost reductions for direct labour, material and overhead. These cost reductions will be achieved through continuous improvements in the internal and external parts supply chain using lean manufacturing technology, through continued negotiation of long-term agreements for the majority of key suppliers, through increased efficiency of plant capacity augmented by technological improvements, and through continued focus on cost targets at all levels of the organization. Significant reductions in the direct labour force, staff and management have been undertaken as a result of reductions in aircraft production rates in 2009. The number of employees has been reduced by 36% since December 31, 2008 causing a relative cost escalation due to an increase in seniority of the workforce. Production related material and shop supply costs have been reduced proportionately with anticipated program delivery reductions. Facilities are being consolidated in order to increase utilization and reduce overhead costs. All discretionary spending is being reviewed and controlled by senior management, with expenditures focused on expediting new commercial program business growth and launching of long-term defence programs. However, fixed overhead costs are having an adverse impact on the Company's cost structure as revenues decrease. In this regard, the Company has renegotiated fees and rates with some of its sustaining service providers.

Composite Materials

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

Outlook

Current economic conditions have caused the Company's current order backlog to decline during 2009. The Company continues to work towards securing additional defence programs in order to augment and diversify its backlog. The Company began delivering products under its military contracts in 2009 and is currently negotiating long-term supply agreements. Assuming long-term agreements are secured, the Company believes that revenues from its military customers will increase to 2013 and extend past 2020. The Company expects to primarily finance investment in the start-up of new military defence programs with milestone payments from customers, though this cannot be assured. Boeing will be the Company's largest customer in 2010, followed by Cessna and Bombardier.

The Company forecasts its 2010 revenue levels to be slightly increased over 2009 primarily as a result of full rate production for programs introduced during 2009 and re-start of programs which were dormant during 2009. With the exception of capital expenditures required for new programs, the Company's investment in new equipment will be maintained at 2009 levels. The Company has reduced the number of its employees by 36% since December 31, 2008; however, anticipates rehiring a portion of its workforce to meet increased 2010 customer delivery requirements. All suppliers have had their orders deferred to the extent possible in order to reduce inventory levels to that required to support the forecasted reduced level of revenues.

The Company forecasts its financing requirements for 2010 to exceed the current availability of the operating line of credit. Accordingly, the Company has completed private placements and a rights offering, and will continue its efforts to obtain additional debt financing, renegotiate debt repayments, reduce operating expenses and manage customer payments to existing terms in order to provide liquidity in excess of forecasted requirements. However, success of these activities cannot be assured.

Transactions with Related Parties

During the year ended December 31, 2005, the Company entered into an agreement under which the former Chairman of the Board and shareholder in consideration of mutual agreements with a Canadian chartered bank under which the former Chairman of the Board and shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. As at October 7, 2009, the guarantee was reduced to $1,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a fee of 20% on the remaining $1,000,000 limited guarantee calculated on a daily basis. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2009 amounted to $300,000 (December 31, 2008: $100,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2009 are $Nil (December 31, 2008: $100,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $200,000 for the year ended December 31, 2009 (December 31, 2008: $125,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders and former directors on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2009 amounted to $120,000 (December 31, 2008: $84,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2009 are $Nil (December 31, 2008: $120,000). These fees are included in the Statements of Operations as cost of sales and amount to $Nil for the year ended December 31, 2009 (December 31, 2008: $180,000).

During the year ended December 31, 2009, consulting services in support of re-financing the Company were provided by certain directors. Fees paid to certain directors, or Companies with which they have beneficial ownership, during the year ended December 31, 2009 amounted to $85,000 (December 31, 2008: $84,000). Fees payable to certain directors, or Companies with which they have beneficial ownership, as at December 31, 2009 are $10,000 (December 31, 2008: $Nil). These fees are included in the Statements of Operations as administrative and general expenses and amount to $95,000 for the year ended December 31, 2009 (December 31, 2008: $37,000).

On June 15, 2009, the Company received $1,552,000 from Panta Holdings B.V. in the form of a bridge loan for general working capital purposes. The bridge loan bore interest at 8% per annum. Security was provided in the form of a security interest in all of the Company's present and after-acquired personal property. This bridge loan and accrued interest was repaid from proceeds of a private placement completed on July 21, 2009. On September 3, 2009, a Principal of Panta Holdings B.V. was elected to the Company's Board of Directors.

On July 7, 2009, the Company entered into an agreement with the former Chairman of the Board and shareholder, having the following terms:

- the Company repaid a $400,000 demand loan and accrued interest on closing of a private placement;
- the Company repaid all fees and amounts owing on closing of a private placement;
- the Company reduced a $2,000,000 limited guarantee provided by the certain shareholder on the indebtedness of the Company to the Bank by $1,000,000 such that the total amount guaranteed by the certain shareholder totals $1,000,000 upon closing of the rights offering; and

- the Company will use its best efforts to completely remove the shareholder's limited guarantee to the Bank as soon as reasonably practicable or no later than December 31, 2010. The Company will continue to pay the certain shareholder the aggregate guarantee fee currently paid.

On July 13, 2009, the Company entered into an agreement for a second bridge loan provided by Panta Holdings B.V. The bridge loan advanced $4,000,000. The bridge loan bore interest at 8% per annum. Security was provided in the form of a security interest in all of the Company's present and after-acquired personal property. This bridge loan and accrued interest payable was repaid from proceeds of a rights offering completed on October 7, 2009.

Other related-party transactions are disclosed within the discussion of cash flows from financing activities.

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

Fourth Quarter

The following summarizes financial results for the fourth quarter 2009.

Operating losses for the fourth quarter of 2009 were $1,936,000 from $16,641,000 in revenues, as compared to operating losses of $1,561,000 from $34,434,000 in revenues for the quarter ended December 31, 2008. The major contributing cause to an operating loss for the fourth quarter of 2009 were continued low revenues, an increase in the provisions for loss-making contracts amounting to $238,000, a $793,000 write-off of obsolete assets, and $1,449,000 expensed during the quarter as a result of idle plant capacity. EBITDA decreased significantly from positive $1,141,000 in the fourth quarter of 2008 to negative EBITDA of $1,377,000 for the same quarter this year. The significant reduction in EBITDA was attributable to the above-noted factors.

Proposed Transactions

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

Critical Accounting Estimates

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

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

- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The December 31, 2009 provision for anticipated losses was $1,080,000 (December 31, 2008: $564,000). The increase in this provision from December 31, 2008 was primarily due to providing for anticipated future losses during the start-up phase of the Cessna Citation CJ4 business jet program.

- Unamortized development and tooling costs, net of related government assistance, which reflect the Company's investment in new programs and manufacturing process development, are recorded at $3,923,000 (December 31, 2008: $3,299,000). These costs are to be amortized over the number of units which management believes is a conservative estimate of deliveries for the programs to the customer. Development costs will be written off proportionately to any anticipated reduction in expected unit deliveries to the customer. Current reductions in deliveries have not impacted amortizations over the expected life of these aircraft programs. Furthermore, the Company will write off any amounts of development costs, which it estimates will not be recoverable from the recurring programs to which they relate. At this time, management estimates that all development costs are recoverable.

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

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

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

- During 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $1,454,000 discounted charge within cost of sales in 2007. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made and is estimated to be recoverable. Accordingly, a $1,454,000 recovery was accrued within cost of sales. During 2009, the Company revised its discounted warranty provision to $1,647,000 and discounted warranty recovery to $1,637,000. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur over the next two to three year period.

Measurement Uncertainty:

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

- Carrying value of long-lived assets - The Company holds property, plant and equipment, and intangible assets on the balance sheet amounting to $19,164,000 (December 31, 2008: $21,585,000). The recoverability of the carrying value of these assets is, in part, dependant on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on market conditions including demand for such aircraft for which the Company provides its products.

- Recoverability of deferred tooling costs - The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2009, $3,923,000 (December 31, 2008: $3,299,000) in unamortized deferred tooling costs, which are expected to be recoverable from the related future cash flows of such new operations, are presented as Development Costs in the balance sheet.

- In accordance with Canadian GAAP the carrying value of long-lived assets is tested for impairment. Circumstances such as the decline in the Company's share price, the significant reduction in customer orders, and the financial condition of the Company may exist and indicate that the carrying amount of long-lived assets may not be recoverable. The aforementioned circumstances existed for the Company as at December 31, 2009 indicating that an assessment for impairment was required. An impairment assessment was made which considered the undiscounted cash flows from forecasted customer orders. The result of the impairment assessment indicated that long-lived assets were recoverable from forecasted future cash flows.

Financial Instruments and Other Instruments

Interest rate risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 3%. The maximum operating line of credit availability is $15,000,000. The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the year ended December 31, 2009, with other variables unchanged, a 1% change in the bank prime interest rate would have a $84,000 impact on net earnings or cash.

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

Currency risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange gain recorded in 2009 was $4,412,000 as compared to a $2,349,000 loss for the year-ended December 31, 2008. The Company used derivative financial instruments to mitigate its exposure to currency risks in 2009 and 2008.

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

Accounts receivable	$ 4,028,000
Bank indebtedness	1,129,000
Accounts payable	829,000
Long-term debt	1,865,000

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

Other Items

Disclosure Controls and Procedures, and Internal Controls over Financial Reporting

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

The Chief Executive Officer and the Vice President, Finance, have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of December 31, 2009 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, 2009, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

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

report of management

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

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

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

report of auditors

To the Shareholders of Avcorp Industries Inc.

We have audited the consolidated balance sheets of Avcorp Industries Inc. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive loss, deficit and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for each of the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP	PRICEWATERHOUSECOOPERS LLP Chartered Accountants

Vancouver, British Columbia
March 26, 2010

Consolidated Balance Sheets

as at December 31, 2009 and December 31, 2008 (in thousands of Canadian dollars)

	December 31, 2009	December 31, 2008
Assets		
Current assets		
Accounts receivable	$ 6,689	$ 12,609
Inventories (note 7)	15,497	19,206
Prepayments	1,092	1,761
Other assets (note 6e)	24	746
	23,302	34,322
Development costs (note 8)	3,923	3,299
Property, plant and equipment (note 9)	17,346	19,431
Warranty claim receivable (note 23c)	1,637	1,784
Intangible assets (note 11)	1,818	2,154
	48,026	60,990
Liabilities		
Current liabilities		
Bank indebtedness (note 12)	8,422	14,273
Accounts payable and accrued liabilities	7,929	15,841
Current portion of long-term debt (note 15)	6,131	6,273
	22,482	36,387
Deferred gain	405	453
Lease inducement (note 14)	863	962
Deferred tooling revenues (note 13)	3,116	1,173
Long-term debt (note 15)	1,811	2,872
Warranty provision (note 23c)	1,647	1,632
Future income tax liability (note 24b)	858	1,186
	31,182	44,665
Shareholders' Equity		
Capital stock (note 17)	71,954	62,269
Preferred shares (note 18)	7,622	7,622
Contributed surplus (note 17e)	2,647	2,647
Deficit	(65,379)	(56,213)
	16,844	16,325
	48,026	60,990

Nature of operations and going concern (note 1)
Measurement uncertainty (note 3)
Subsequent events (note 27)

Approved by the Board of Directors

David Levi
Chairman

Eric Kohn
Committee Chair,
Audit & Corporate Governance Committee

Consolidated Statements of Operations and Comprehensive Loss
For the years ended December 31, 2009 and 2008
(in thousands of Canadian dollars, except number of shares and per share amounts)

For the year ended December 31	2009	2008
Revenues	$ 69,202	$ 128,868
Cost of sales and expenses		
Cost of sales	64,555	107,188
Administrative and general expenses	10,477	13,676
Amortization and depreciation	4,083	4,599
Write-down of goodwill	-	571
Foreign exchange (gain) loss (note 6a)	(4,412)	2,349
	74,703	128,383
Income (Loss) from operations	(5,501)	485
Interest expense and financing charges (note 21)	(1,739)	(2,479)
Unrealized derivative gain (loss) (note 6e)	(705)	502
Write-down of investment (note 10)	-	(759)
Write-down of assets no longer in use (note 9)	(793)	-
Loss before income taxes	(8,738)	(2,251)
Future Income Tax Recovery	328	-
Loss and comprehensive loss for the period	(8,410)	(2,251)
Basic and diluted loss per common share	(0.12)	(0.07)
Basic and diluted weighted average number of shares outstanding (000's)	69,632	32,143

Consolidated Statements of Deficit
For the years ended December 31, 2009 and 2008
(in thousands of Canadian dollars)

For the year ended December 31	2009	2008
Deficit – Beginning of period	$ (56,213)	$ (53,204)
Loss for the period	(8,410)	(2,251)
Preferred share dividends	(756)	(758)
Deficit – End of period	(65,379)	(56,213)

Consolidated Statements of Cash Flows
For the years ended December 31, 2009 and 2008
(in thousands of Canadian dollars)

For the year ended December 31	2009	2008
Cash flows from operating activities		
Loss for the period	$ (8,410)	$ (2,251)
Items not affecting cash (note 22a)	6,408	7,663
	(2,002)	5,412
Change in non-cash items related to operating activities (note 22b)	509	(589)
	(1,493)	4,823
Cash flows from investing activities		
Purchase of property, plant and equipment	(402)	(2,771)
Proceeds from disposal of property, plant and equipment	58	-
Payments relating to development costs and tooling	(2,586)	(2,766)
	(2,930)	(5,537)
Cash flows from financing activities		
(Decrease) increase in bank indebtedness	(5,851)	2,994
Proceeds from current and long-term debt	5,952	131
Proceeds from sale and leaseback of property, plant and equipment	-	1,215
Proceeds from sale of tooling	2,309	103
Repayment of current and long-term debt	(2,738)	(3,342)
Issue of common shares net of debt repayment set-off	5,244	371
Preferred share dividends	-	(758)
Share issue expense	(493)	-
	4,423	714
Net change in cash and cash equivalents	-	-
Cash and cash equivalents - Beginning of period	-	-
Cash and cash equivalents - End of period	-	-
Interest paid	1,300	1,714

1 Nature of operations and going concern

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

For the year ended December 31, 2009, the Company recorded a net loss of $8,410,000 on $69,202,000 revenue, as compared to a $2,251,000 net loss from $128,868,000 revenue for the year ended December 31, 2008. The Company has a working capital surplus of $820,000 as at December 31, 2009 (December 31, 2008: $2,065,000 deficit) and an accumulated deficit of $65,379,000 at December 31, 2009 (December 31, 2008: $56,213,000).

As at December 31, 2009, the Company was not in compliance with a financial covenant associated with its operating lines of credit. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment. The lender had agreed to forbear from demanding payment of the indebtedness and from taking steps to enforce the security subject to the Company complying with terms and conditions of a Forbearance Agreement which ended on November 10, 2009 (note 12). On March 11, 2010, the Company and the Bank entered into a follow-on Forbearance Agreement which will expire on June 9, 2010 (note 27c).

Also, as at December 31, 2009, the Company was not in compliance with a financial covenant associated with the convertible debenture held by Export Development Canada (note 15a). The Company has obtained a waiver from the debenture holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such future breaches, the lender would be entitled to demand payment. Accordingly, the convertible debenture is classified as current debt. The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage.

During June 2009, the Company's Board of Directors resolved to defer Preferred Share dividends until January 2011. The Company has not paid $756,000 of preferred share dividends which were accrued and payable as at December 31, 2009.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The conditions and risks noted above cast significant doubt on the validity of that assumption. The Company forecasts its financing requirements in the next 12 months to exceed the current availability of the operating line of credit. Accordingly, the Company has completed a private placement and rights offering, and will continue its efforts to obtain additional debt financing, renegotiate debt repayments, issue additional common shares, reduce operating expenses and maintain existing terms regarding customer collections in order to provide liquidity in excess of forecasted requirements. However, the success of these activities cannot be assured.

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

2 Significant Accounting Policies

Use of estimates

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

Principles of consolidation

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

Revenue

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

Stock-based compensation

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

Income taxes

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

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

Income or loss per common share

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

Translation of foreign currencies and financial instruments

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

Inventories

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

Research and development costs

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

Government assistance

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

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

Property, plant and equipment

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

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

Impairment of long-lived assets

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

Investments

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

Intangible assets

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

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

Goodwill

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

Convertible loans and debentures

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

Asset retirement obligations

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

Leases

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

3 Measurement Uncertainty

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

- Carrying value of long-lived assets

  The Company holds property, plant and equipment, (note 9) and intangible assets (note 11) on the balance sheet amounting to $19,164,000 (December 31, 2008: $21,585,000). The recoverability of the carrying value of these assets is, in part, dependant on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on market conditions including demand for such aircraft for which the Company provides its products.

- Recoverability of deferred tooling costs

  The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2009, $3,923,000 (December 31, 2008: $3,299,000) in unamortized deferred tooling costs (note 8), which are expected to be recoverable from the related future cash flows of such new operations, are presented as Development Costs in the balance sheet.

4 Accounting

New accounting policies

Effective January 1, 2009, the Company adopted the new Canadian Institute of Chartered Accounts (CICA) standard 3064. Adoption of the standard has not had a significant effect on these financial statements.

- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, “Goodwill and Intangible Assets”, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred. The adoption of this standard has not affected the Company’s consolidated financial statements.

- In January 2009, the CICA approved EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity’s own credit risk and the credit risk of the counter-party should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. The Company has evaluated the new section and determined that adoption of these new requirements did not have a significant impact on the Company’s consolidated financial statements.

Recent accounting pronouncements

For interim and annual financial statements beginning July 1, 2011, the Company will be required to adopt CICA Handbook Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling Interests. Section 1582 replaces Section 1581, Business Combinations and Section 1601 and 1602 together replace Section 1600, Consolidated Financial Statements. The adoption of Sections 1582 and collectively 1601 and 1602 provides the Canadian equivalent to IFRS 3, Business Combinations and International Accounting Standard IAS 27, Consolidated and Separate Financial Statements, respectively. The adoption of this standard is not expected to result in a significant impact on the Company’s financial statements.

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

5 Capital Risk Management

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

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

The Company's primary objective in its management of capital is to ensure that it has sufficient financial resources to fund ongoing operations and new program investment. In order to secure this capital the Company may attempt to raise funds via issuance of debt and equity, or by securing strategic partners (notes 12, 15, 17, 25 and 27). The financial covenants by which the Company's debt agreements are bound are working capital, debt to tangible net worth, and debt service coverage ratios (notes 12 and 15a). Other matters relating to capital risk management are set out in note 1.

6 Financial Risk Management

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

a) Currency Risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange gain recorded in 2009 was $4,412,000 as compared to a $2,349,000 loss for the year-ended December 31, 2008.

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

	2009	2008
Accounts receivable	$ 4,028	$ 6,585
Bank indebtedness	1,129	19,514
Accounts payable	829	4,835
Long-term debt	1,865	2,431

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in a (decrease) increase of approximately $20,000 in net earnings for the year ended December 31, 2009 (December 31, 2008: $2,020,000) as a result of holding a net asset US dollar position.

Foreign Exchange Forward Contracts

During 2008, the Company entered into USD25,000,000 of foreign-exchange-forward contracts which were executed during 2009, with the provider of its operating lines of credit. No such instruments were in place as at December 31, 2009. The Company has recorded a $708,000 derivative loss during the year-ended December 31, 2009 (December 31, 2008: $538,000 unrealized derivative gains).

b) Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counter-party to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group (Boeing), Boeing Defense, Space & Security (BDS), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna). The maximum exposure to credit risk is represented by the amount of accounts receivable in the balance sheet.

As at the balance sheet date 65% (December 31, 2008: 75%) of the Company's trade accounts receivable are attributable to these four customers.

c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company seeks to manage liquidity risk through the management of its capital structure and financial leverage as outlined in note 5 to the consolidated financial statements. Other matters related to liquidity risk are set out in note 1.

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

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

The Company's operating line of credit is due on demand. Long-term debt repayments are as outlined in note 15.

d) Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 3% (note 12). The maximum operating line of credit availability is $15,000,000. The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the year ended December 31, 2009, with other variables unchanged, a 1% change in the bank prime interest rate would have a $84,000 (December 31, 2008: $143,000) impact on net earnings or cash.

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

e) Price Risk

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

Sales Contracts

A number of the Company's sales contracts have a price adjustment clause where the final sales price is determined by certain indices in a period prior to the date of sale. As a result, the final sales price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of sale. As at December 31, 2009, the Company has $4,442,000 (December 31, 2008: $23,098,000) of firmly committed orders that include price adjustment clauses of this nature. A $4,000 gain has been recorded in unrealized derivative gains for the year ended December 31, 2009 as compared to a $36,000 loss for the year ended December 31, 2008 as a result of the change in the fair value of the underlying embedded derivatives.

Purchase Contracts

A number of the Company's purchase contracts have a price adjustment clause where the final purchase price is determined by certain indices in a period prior to the date of purchase. As a result, the final purchase price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of purchase. As at December 31, 2009, the Company has $445,000 (December 31, 2008: $764,000) of firmly committed purchases that include price adjustment clauses of this nature. A $1,000 loss has been recorded in unrealized derivative income for the year ended December 31, 2009 as compared to a $Nil gain or loss for the year ended December 31, 2008 as a result of the change in the fair value of the underlying embedded derivatives.

Other Assets and Liabilities

Other assets are comprised of $24,000 inflation derivatives assets arising from the Company's sales and purchase contracts having price adjustment clauses within their terms (December 31, 2008: $38,000), and $Nil fair value derivatives assets arising from foreign-exchange-forward contracts (December 31, 2008: $708,000).

f) Financial Assets and Liabilities by Category

As at December 31, 2009 and 2008, the Company's financial assets and liabilities are categorized as follows:

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

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

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

g) Fair values

The fair values of the Company's accounts receivable are estimated to approximate their carrying values due to the immediate or short-term maturity of these financial instruments. The fair value of the Company's bank indebtedness, accounts payable and accrued liabilities and current portion of long-term debt are significantly lower than carrying value due to the Company's current financial condition. The fair value of the long-term debt cannot be reliably estimated due to the current financial condition of the Company.

7 Inventories

	2009	2008
Raw materials	$ 6,419	$ 5,768
Work in progress	8,646	12,219
Finished products	432	1,219
	15,497	19,206

The amount of inventory expensed in cost of sales during the year-ended December 31, 2009 amounted to $59,184,000. The carrying value of inventory pledged as security as at December 31, 2009 is $15,497,000.

8 Development Costs

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

	2009	2008
Opening balance	$ 3,299	$ 1,545
Additions	712	2,766
Amortization	(88)	(1,012)
	3,923	3,299

Additions exclude $1,884,000 of costs incurred under development projects which were completed during the year and subsequently reclassified to Property, Plant and Equipment (note 9).

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

9 Property, Plant and Equipment

	2009			2008		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Computer hardware and software	$ 7,608	$ 5,655	$ 1,953	$ 8,396	$ 5,125	$ 3,271
Machinery and equipment	35,704	20,832	14,872	37,209	21,634	15,575
Leasehold improvements	985	464	521	956	371	585
	44,297	26,951	17,346	46,561	27,130	19,431

Included in computer hardware and software are assets held under capital leases at a cost of $1,395,000 (2008: $1,377,000) having accumulated depreciation of $931,000 (2008: $633,000).

Included in machinery and equipment are assets held under capital leases at a cost of $5,006,000 (2008: $5,653,000) having accumulated depreciation of $735,000 (2008: $903,000).

Also included in machinery and equipment is aircraft tooling which will be amortized to cost of sales, using the lesser of straight-line on a unit-of-production basis over the expected life of the program or the contract period for the program. Machinery and equipment includes $1,884,000 of costs incurred under development projects which were completed during the year and subsequently reclassified from Development Costs (note 8).

Included in leasehold improvements are assets held under capital leases at a cost of $52,000 (2008: $52,000) having accumulated depreciation of $11,000 (2008: $7,000).

During 2009 equipment which was no longer in use was written down. This equipment had a cost of $4,511,000, and a accumulated depreciation of $3,891,000. Proceeds amounting to $58,000 were received for this equipment; resulting in a $562,000 charge against income. Foregone deposits on planned equipment purchases amounted to a $231,000 charge against income.

10 Investment

On December 31, 2008, the Company determined that its investment consisting of 5,264 Series D Preferred Stock of Eclipse Aviation Corporation was subject to an other than temporary impairment and wrote the carrying value of $759,000 down to an estimated fair value of $Nil.

11 Intangible Assets

	Remaining Estimated Useful Lives (years)	December 31, 2009			December 31, 2008		
		Cost	Accumulated Amortization	Net	Cost	Accumulated amortization	Net
Customer relationships	5	$ 1,320	$ 378	$ 942	$ 1,320	$ 189	$ 1,131
Trade name	3	300	120	180	300	60	240
Patents	8	870	174	696	870	87	783
		2,490	672	1,818	2,490	336	2,154

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

12 Bank Indebtedness

The Company has operating lines of credit with a Canadian chartered bank totalling $15,000,000 (December 31, 2008: $17,000,000). The facilities are due on demand.

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

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

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

- the credit available to the Company under its operating lines of credit shall be equal to the amount determined by the margin formula currently in place less $1,000,000 until such time as an equivalent amount is guaranteed by a party acceptable to the bank (note 25c);
- interest at Bank prime plus 3.0%; and
- the Company shall pay the Bank a monthly forbearance fee of $10,000;

The Company is required to maintain certain measures of working capital, debt to tangible net worth, and debt service coverage. As at December 31, 2009, the Company was not in compliance with a financial covenant. In addition, the Company is forecasting that it will be in default of one or more of its covenants in the next 12 months. In the absence of obtaining a waiver of such breach, the lender is entitled to demand immediate payment.

On August 12, 2009, the Company entered into a Forbearance Agreement with the bank providing its operating lines of credit. The Forbearance Agreement ended on November 10, 2009. The Company is subject to a quarterly review within which the Bank determines if there has occurred an event of default. Provided no default has occurred, the Forbearance Agreement is extended for a recurring period of 90 days. The Bank has completed a follow-on Forbearance Agreement as at the date of this report (note 27c).

13 Deferred Tooling Revenues

	2009	2008
Opening balance	$ 1,173	$ 2,676
Additions	2,648	104
Amortization	(705)	(1,607)
	3,116	1,173

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

14 Lease Inducement and Prepaid Rent

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

The lease inducement credit is being amortized against rental expense over the term of the lease. It has an unamortized balance of $863,000 as at December 31, 2009 (December 31, 2008: $962,000). The related prepaid rent amount recorded of $1,500,000 was charged to rental expense over the term of a rent-free period which arose in 2008 and 2009. Consequently, $374,000 of the rental prepayment has been amortized during 2009 (2008: $1,126,000).

15 Long-Term Debt

	2009	2008
Convertible debenture (a)	$ 4,338	$ 4,097
Capital leases (b)	2,689	4,096
Accrued government royalties (c)	915	952
	7,942	9,145
Less: Current portion	(6,131)	(6,273)
	1,811	2,872

a) Convertible Debenture

During 2009, certain terms of the convertible debenture were changed. $241,000 of accrued interest was capitalized resulting in a principal balance of $4,338,000 outstanding as at December 31, 2009.

The principal outstanding debenture amount of $4,338,000 is convertible at the option of the holder (Export Development Canada) into 1,141,512 shares at a conversion price of $3.80. The Company can require conversion of the full amount of the debenture in the event that the weighted average trading price of the Company's shares on the Toronto Stock Exchange is greater than 125% of the conversion price for 20 consecutive days.

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

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

Provided no default has occurred, the Company will not be obligated to pay any interest or principal until the debenture matures on March 31, 2011.

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

As at December 31, 2009, the Company was not in compliance with a financial covenant associated with the convertible debenture. The Company has obtained a waiver from the debt holder for this non-compliance; it has not obtained a waiver for anticipated future breaches. In the absence of obtaining a waiver of such future breach, the lender would be entitled to demand immediate payment. Accordingly, the convertible debenture is classified as current debt.

b) Capital Leases

There are various equipment leases that have a weighted average interest rate of 7.0% 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. $1,960,000 of the leases are held in US dollars.

c) Accrued Government Royalties

Royalties of $915,000 (December 31, 2008: $952,000) are payable to Industrial Technologies Office. $90,000 of the outstanding amount in repayable by March 31, 2010. As at December 31, 2009, the Company was in discussion with Industrial Technologies Office regarding the terms of repayment for the balance (note 27a).

16 Obligations and Commitments Under Capital and Operating Leases

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

		2009		2008
	Operating	Capital	Operating	Capital
2009	$ -	$ -	$ 2,527	$ 1,223
2010	2,397	1,036	2,861	1,147
2011	2,620	1,022	2,774	987
2012	2,566	723	2,532	795
2013	2,564	94	2,556	94
2014	2,564	-	2,580	-
Thereafter	9,649	-	9,704	-
Total future minimum lease payments	22,360	2,875	25,534	4,247
Less: Imputed interest	n/a	(186)	n/a	(150)
Balance of obligation under capital leases included in long-term debt (note 15)	n/a	2,689	n/a	4,096

For the year ended December 31, 2009, an amount of $2,139,000 representing payments under operating leases was expensed (2008: $2,775,000).

17 Capital Stock

Authorized

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

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

Common shares issued or reserved:

	Number of shares	Amount
December 31, 2007	31,444,724	61,194
Share issue (c)		
Cash	411,294	371
Conversion from Preferred Shares	28,571	50
Non-cash	430,340	387
	870,205	808
Transfer from contributed surplus on exercise of options and warrants	-	267
December 31, 2008	32,314,929	62,269
Share issue (b)		
Cash	78,824,445	5,244
Non-Cash	66,592,738	4,934
Issuance costs	-	(493)
	145,417,183	9,685
Transfer from contributed surplus on exercise of options and warrants	-	-
December 31, 2009	177,732,112	71,954

a) The Company has reserved a total of 1,141,512 common shares for issuance, the maximum number that may be exercised under the terms of the convertible debenture due on March 31, 2011 (note 15a).

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

i) Common Share Issue

On July 21, 2009, the Company issued 16,157,465 common shares to Panta Holdings B.V. at $0.15 per share providing gross proceeds of $2,423,000 (note 25b). The Company received aggregate net proceeds of $858,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V. (note 25b).

On October 7, 2009, the Company completed a rights offering within which 129,259,718 common shares were issued at $0.06 per share providing gross proceeds of $7,755,000. The Company received aggregate net proceeds of $4,386,000 after set off against certain bridge loan obligations owed to Panta Holdings B.V. (note 25d)

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

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

i) Exercise of Warrants

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

ii) Exercise of Options

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

iii) Exercise of Preferred Shares

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

d) The Company's incentive stock option plan is administered by the Board of Directors. The maximum number of common shares that currently may be optioned is 3,166,667. The stock option plan is a fixed plan, whereby the period during which an option is exercisable shall not exceed 10 years.

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

A summary of the Company's stock option plan as of December 31, 2009 and December 31, 2008, and changes during the periods ending on those dates, is presented below.

	2009		2008	
	Shares (000's)	Weighted Average Exercise Price	Shares (000's)	Weighted Average Exercise Price
Outstanding - Beginning of year	60	$ 1.85	940	$ 1.28
Granted	-	-	-	-
Forfeited	(60)	1.85	(713)	1.33
Exercised	-	-	(167)	0.90
Outstanding - End of year	-	-	60	1.85

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

	2009	2008
Beginning of year	$ 2,647	$ 2,857
Stock-based compensation expense	-	57
Transfer to capital stock on exercise of options and warrants	-	(267)
End of year	2,647	2,647

f) The Company has 450,000 warrants outstanding as at December 31, 2009 (December 31, 2008: 1,327,880) the recorded fair value of which is $71,000. During the current year 877,880 warrants expired having a fair value of $414,000.

18 Preferred Shares

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

The preferred shares provide for a 9.25% per annum dividend, payable quarterly in cash on the last day of March, June, September and December with the first dividend paid on December 31, 2006. Dividends paid during the year ended December 31, 2009 amounted to $Nil (December 31, 2008: $758,000). Unpaid dividends as at December 31, 2009 amounted to $756,000 (December 21, 2008: $Nil).

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

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

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

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

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

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

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

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

19 Stock-Based Compensation

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

No stock options were granted during the year ended December 31, 2009.

20 Defined Contribution Plan

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

	2009	2008
Defined contribution plan	$ 1,241	$ 1,438

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

21 Interest Expense and Financing Charges

	2009	2008
Interest on capital leases	$ 236	$ 263
Interest on other long-term debt	287	303
Interest on short-term debt	923	1,788
Interest on related party debt	293	125
Net interest expense	1,739	2,479

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

22 Supplementary Cash Flow Information

a) Items not affecting cash:

	2009	2008
Accrued interest and government royalties	$ 839	$ 1,290
Amortization and depreciation	4,083	4,599
Deferred tooling revenue amortization	(1,018)	(1,710)
Development cost amortization	88	1,012
Expenses settled by issue of common shares	-	387
Foregone deposit on equipment purchase	231	-
Future income tax liability	(328)	-
Prepaid rent amortization	374	1,126
Provision for loss-making contracts	515	(497)
Provision for obsolete inventory	901	239
Unrealized derivative gains	722	(608)
Warranty provisions	(102)	15
Write-down of equipment	562	-
Write-down of goodwill	-	571
Write-down of investment	-	759
Other items	(459)	480
	6,408	7,663

b) Changes in non-cash items:

	2009	2008
Accounts receivable	$ 6,574	$ (384)
Inventories	2,293	(1,147)
Prepayments	205	(5)
Warranty claim receivable	243	(164)
Accounts payable and accrued liabilities	(8,752)	1,010
Warranty provision	(54)	101
	509	(589)

c) Non-cash financing and investing activities:

	2009	2008
Assets acquired under capital leases	$ 33	$ 483
Repayment of debt and interest via issue of common shares	4,934	-
Conversion of preferred shares	-	50
Uncollected deferred tooling revenue	652	-
Offset of accounts payable against warranty claim receivable	75	-

23 Contingencies

a) The Company has agreements with Industrial Technologies Office (ITO), under which ITO will make cash contributions to the Company's various projects, up to a cumulative maximum of $8,912,000. In return, a royalty will be paid to ITO by the Company based on the selling price and units sold. During the year ended December 31, 2009, the Company received $Nil (2008: $131,000) from ITO. This amount was credited to development costs, as it related directly to certain long-term programs, and as a recovery of expenses.

b) The Company's subsidiary, Comtek Advanced Structures Ltd. has an agreement with ITO, under which ITO has made cash contributions to Comtek Advanced Structures Ltd.'s various projects, in the amount of $3,325,000. In return, a $350,000 royalty will be paid to ITO by Comtek Advanced Structures Ltd. via a series of payments with the final balance due March 31, 2010. As at December 31, 2009 $90,000 remains unpaid.

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

c) During 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect effects delivered product, the Company accrued a $1,454,000 discounted charge within cost of sales in 2007. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $1,454,000 recovery was accrued within cost of sales. During 2009, the Company revised its discounted warranty provision to $1,647,000 and discounted warranty recovery to $1,637,000. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur during the next two to three year period.

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

24 Income Taxes

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

	2009	2008
Combined basic income tax rate	30.0%	31.0%
Income tax (recovery) at the basic income tax rate	$ (2,523)	$ (698)
Adjustment of provision to tax return	(1,000)	-
Impact of change in statutory income tax rate	239	987
Share issue costs	(124)	-
Change in valuation allowance	2,991	(618)
Other	89	329
Future income tax recovery	(328)	-

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

	2009	2008
Future income tax assets (liability)		
Non-capital losses	$ 5,729	$ 5,383
Scientific research expenditures	2,229	2,318
Investment	382	199
Capital losses	623	648
Property, plant and equipment	5,554	5,053
Gain deferred for accounting purposes	1,112	566
Expenses not deductible in current period	1,722	1,279
Financing costs	284	292
Investment tax credits	1,945	791
Intangible asset	(492)	(761)
	19,088	15,768
Less: Valuation allowance	(19,946)	(16,954)
Net future income tax asset (liability)	(858)	(1,186)

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

c) The Company has available non-capital loss carry-forwards totalling approximately $22,915,000. These losses expire as follows:

Expiry Date	Loss Carry-Forwards
2010	$ 4,011
2014	5,451
2015	8,416
2026	465
2027	2,781
2028	29
2029	1,762

d) The Company has approximately $9,753,000 of unclaimed research and development costs that may be claimed against future taxable income.

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

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

Expiry Date	ITC
2018	$ 1,603
2019	705
2022	364
2027	30
2028	206

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

25 Related Party Transactions

a) During the year ended December 31, 2005, the Company entered into an agreement under which the former Chairman of the Board and shareholder in consideration of mutual agreements with a Canadian chartered bank under which the former Chairman of the Board and shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. As at October 7, 2009, the guarantee was reduced to $1,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a fee of 20% on the remaining $1,000,000 limited guarantee calculated on a daily basis. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2009 amounted to $300,000 (December 31, 2008: $100,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2009 are $Nil (December 31, 2008: $100,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $200,000 for the year ended December 31, 2009 (December 31, 2008: $125,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders and former directors on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to the former Chairman of the Board and shareholder during the year ended December 31, 2009 amounted to $120,000 (December 31, 2008: $84,000). Fees payable to the former Chairman of the Board and shareholder as at December 31, 2009 are $Nil (December 31, 2008: $120,000). These fees are included in the Statements of Operations as cost of sales and amount to $Nil for the year ended December 31, 2009 (December 31, 2008: $180,000).

During the year ended December 31, 2009, consulting services in support of re-financing the Company were provided by certain directors. Fees paid to certain directors, or Companies with which they have beneficial ownership, during the year ended December 31, 2009 amounted to $85,000 (December 31, 2008: $84,000). Fees payable to certain directors, or Companies with which they have beneficial ownership, as at December 31, 2009 are $10,000 (December 31, 2008: $Nil). These fees are included in the Statements of Operations as administrative and general expenses and amount to $95,000 for the year ended December 31, 2009 (December 31, 2008: $37,000).

b) On June 15, 2009, the Company received $1,552,000 from Panta Holdings B.V. in the form of a bridge loan for general working capital purposes. The bridge loan bore interest at 8% per annum. Security was provided in the form of a security interest in all of the Company's present and after-acquired personal property. This bridge loan and accrued interest was repaid from proceeds of a private placement completed on July 21, 2009 (note 17b). On September 3, 2009, a Principal of Panta Holdings B.V. was elected to the Company's Board of Directors.

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

c) On July 7, 2009, the Company entered into an agreement with the former Chairman of the Board and shareholder, having the following terms:

- the Company repaid a $400,000 demand loan and accrued interest on closing of a private placement;
- the Company repaid all fees and amounts owing (note 25a) on closing of a private placement;
- the Company reduced a $2,000,000 limited guarantee provided by the certain shareholder on the indebtedness of the Company to the Bank (note 12) by $1,000,000 such that the total amount guaranteed by the certain shareholder totals $1,000,000 upon closing of the rights offering; and
- the Company will use its best efforts to completely remove the shareholder's limited guarantee to the Bank as soon as reasonably practicable or no later than December 31, 2010. The Company will continue to pay the certain shareholder the aggregate guarantee fee currently paid (note 12).

d) On July 13, 2009, the Company entered into an agreement for a second bridge loan provided by Panta Holdings B.V. The bridge loan advanced $4,000,000. The bridge loan bore interest at 8% per annum. Security was provided in the form of a security interest in all of the Company's present and after-acquired personal property. This bridge loan and accrued interest was repaid from proceeds of a rights offering completed on October 7, 2009 (note 17b).

Other related-party transactions are disclosed elsewhere in these financial statements (note 17b and 27b).

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

26 Economic Dependence and Segmented Information

a) Sales to three major customers for the year ended December 31, 2009, which comprise several programs and contracts, accounted for approximately 81.8% (December 31, 2008: 86.9%) of sales.

	2009		2008	
	Revenue	% of Total	Revenue	% of Total
Boeing	$ 23,493	33.9	$ 18,518	14.4
Bombardier	17,681	25.6	28,760	22.3
Cessna	15,419	22.3	64,710	50.2
Other	12,609	18.2	16,880	13.1
Total	69,202	100.0	128,868	100.0

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

27 Subsequent Events

a) On February 5, 2010, the Company signed an amended agreement with Industrial Technologies Office deferring royalty repayments to April 30, 2012.

b) On March 1, 2010, the Company completed a private placement of 17,773,211 common shares at $0.055 per share for gross proceeds of approximately $978,000. Subscribers in the private placement are Panta Holdings B.V., which has subscribed for 15,995,890 common shares, and Working Opportunity Fund (EVCC) Ltd., which has subscribed for 1,777,321 common shares. The common shares issued under the private placement are subject to a restriction on resale for a period of four months and one day from the date of issue, in accordance with applicable Canadian securities laws.

c) On March 11, 2010, the Company entered into a Forbearance Agreement with the Bank providing its operating lines of credit. The Forbearance Agreement renews existing terms and conditions and ends on June 9, 2010. Provided no default has occurred the Forbearance Agreement, subject to review by the Bank, is extended for a recurring period of 90 days.

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

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

Jaap Rosen Jacobson (2)
DIRECTOR
Nootdorp, The Netherlands

Kees de Koning (3)
DIRECTOR
Nootdorp, The Netherlands

Elizabeth Otis (3*)
DIRECTOR
Vashon, Washington

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

Paul Kalil
President
Vancouver, British Columbia

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

Amandeep Kaler
Vice President, Operations
Surrey, British Columbia

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

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

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

* Designates the Committee Chair

DIRECTORY

Bank

HSBC Bank Canada
Vancouver, British Columbia

Legal Counsel

Lang Michener LLP
Barristers & Solicitors
Vancouver, British Columbia

Registrar and Transfer Agent

CIBC Mellon Trust Company
Vancouver, British Columbia

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
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