AVCORP

annual report 2014

ABOUT AVCORP INDUSTRIES INC. Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including BAE Systems, Boeing and Bombardier. With more than 50 years of experience, over 360 skilled employees and 340,000 square feet of facilities in Delta BC and Burlington ON, Avcorp offers integrated composite and metallic aircraft structures to aircraft manufacturers, a distinct advantage in the pursuit of contracts for new aircraft designs, which require lower-cost, light-weight, strong, reliable structures. Our Burlington location also offers composite repairs for commercial aircraft. Avcorp is a Canadian public company traded on the Toronto Stock Exchange (TSX:AVP).

management discussion & analysis

This Management Discussion and Analysis has been prepared as of March 31, 2015, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2014.

Description of Business

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

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

Avcorp is in compliance with industry standard quality requirements.

Financial Overview

Three-Year Results

The following table provides selected financial information for the three years to December 31, 2014.

THREE-YEAR RESULTS

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

FOR THE YEAR ENDED DECEMBER 31	2014	2013	2012
OPERATIONS			
Revenues	**$ 67,104**	$ 77,364	$ 89,337
EBITDA[1]	**(6,129)**	3,241	29,035
Operating (loss) income before tax	**(8,038)**	(2,015)	24,002
Net (loss) income	**(7,950)**	(1,802)	20,641
Basic (loss) income per share	**(0.03)**	(0.01)	0.09
Diluted (loss) income per share	**(0.03)**	(0.01)	0.09
FINANCIAL POSITION			
Net capital expenditures	**1,001**	1,206	557
Total assets	**35,482**	42,193	68,635
Bank indebtedness and long-term debt	**1,236**	266	7,114
Shareholders' equity	**17,377**	23,551	24,041
Net book value per share	**0.06**	0.08	0.09
Ratio: debt/equity	**0.07**	0.01	0.30
Ratio: current assets/current liabilities	**1.43**	1.79	1.43
Shares outstanding at period end	**302,633,184**	280,391,152	254,898,072

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

Avcorp's recurring contracted revenue base remains strong as customers continue to place orders within existing long-term supply agreements. Deliveries of commercial jet assembly structures rose in 2014 over 2013, while production by Avcorp in supply of defence assembly structures were maintained in 2014 at 2013 levels although certain significant program deliveries were deferred by the customer at year end into the first quarter 2015. Overall revenues decreased in 2014 relative to 2013 as deliveries of business jet assembly structures were reduced in the last quarter of 2013 and continued at a lower production rate through 2014. Customer orders for business jet assembly structures have been received for 2015 which indicate an increase over 2014.

Composite structures repairs and composite floor panel production and deliveries continued to grow posting a 25% revenue growth in 2014 over 2013. During the course of 2014 the Company commenced resetting its direction and approach for securing business growth in the composite aircraft structures assembly market, creating collaborative industry ventures in response to customer demand for cost-effective supply chain solutions. As Avcorp changed its strategic direction and resized operations, significant expenditures were incurred which contributed to the decrease in EBITDA over previous years. 2012 EBITDA was augmented when the Company received an arbitration award amounting to $27,391,000. Cash received from this arbitration award settlement in 2013 allowed the Company to repay its convertible debenture as well as redeem its preferred shares and pay dividends accrued thereon during 2013. Capital expenditures during the three year period presented have been limited to upgrading manufacturing equipment and capabilities, in particular for new program introduction, as well as information technology assets.

Quarterly Results

The following table provides selected unaudited quarterly consolidated financial information for the eight most recent fiscal quarters to December 31, 2014 prepared in accordance with International Financial Reporting Standards ("IFRS").

QUARTERLY RESULTS

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

	2014				2013			
FOR THE THREE MONTHS ENDED	**Dec 31**	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	**$13,744**	**$14,675**	$21,134	$ 17,551	$ 17,159	$ 19,767	$ 20,492	$ 19,946
Operating income (loss)	**(3,848)**	**(2,321)**	(472)	(1,397)	(2,637)	(211)	393	440
EBITDA[1]	**(3,442)**	**(1,794)**	(153)	(740)	(1,580)	514	3,066	1,241
Net income (loss)	**(3,890)**	**(2,229)**	(589)	(1,242)	(2,367)	(1,139)	1,596	108
EBITDA per share[1]								
Basic	**(0.01)**	**(0.01)**	(0.00)	(0.00)	(0.01)	0.00	0.01	0.00
Diluted	**(0.01)**	**(0.01)**	(0.00)	(0.00)	(0.01)	0.00	0.01	0.00
Net income (loss) per share								
Basic	**(0.01)**	**(0.01)**	(0.00)	(0.00)	(0.01)	(0.00)	0.01	0.00
Diluted	**(0.01)**	**(0.01)**	(0.00)	(0.00)	(0.01)	(0.00)	0.01	0.00
Long-term debt	**943**	**152**	223	48	67	3,672	3,835	4,138

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

2014 and 2013 Results Overview

During the year ended December 31, 2014, the Company recorded a loss from operations of $8,038,000 on $67,104,000 revenue, as compared to $2,015,000 operating loss on $77,364,000 revenue for the preceding year; and a net loss for the current year of $7,950,000 as compared to net loss of $1,802,000 for the year ended December 31, 2013.

The Company operates within “general terms agreements” with its customers. These agreements are typically for five years or longer. The contracts provide for long lead-time orders; the civil aerospace business is also slightly seasonal as some aircraft manufacturers reduce or suspend production in December and for a period of time during the summer months. Revenues have decreased during the current year relative to the previous year as the timing of customer demand for certain business jet aircraft structures, and one defence program structure, manufactured by the Company have shifted to 2015.

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

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $5,047,000 of overhead costs during the current year (December 31, 2013: $4,926,000) in respect of unutilized plant capacity. The amount of overhead costs expensed, as a result of unutilized capacity, will fluctuate from quarter to quarter as production in support of deliveries varies. Revenue growth would benefit Company profitability via a contribution to the recovery of fixed overhead expenditures. Avcorp is engaged with aerospace original equipment manufacturers (“OEM”) as well as industry tier 1 suppliers in North America, Asia and Europe in collaborative production initiatives which support the Company’s transition to composite manufacturing capabilities leveraging existing production capacity and investments.

In addition to $5,047,000 expensed for unutilized plant capacity, the current year loss includes $1,076,000 in severance and retiring allowance costs as well as $503,000 in recruitment and related compensation benefits. 2014 loss included a $108,000 foreign exchange gain which resulted from holding foreign currency denominated cash, accounts receivable and accounts payable; while the loss for the year ended December 31, 2013 included a $1,085,000 foreign exchange gain. A slowdown in production for certain business jet assembly structures, as well as near-term process improvement initiatives, has caused production costs for certain aircraft structures assemblies to exceed plan by $1,371,000. Customer orders for these specific programs are increased in 2015 over 2014. Related quality assurance initiative implementation will be completed during the first half of 2015.

Cash flows from operating activities during the year ended December 31, 2014 utilized $2,795,000 of cash as compared to providing $24,028,000 of cash during the year ended December 31, 2013. The primary use of cash from operations during the current year is due to operating losses reflecting temporary reduced customer demand. In contrast collection of an Other Receivable during the third quarter 2013 provided cash during 2013. As at December 31, 2014, the Company had $3,159,000 cash on hand (December 31, 2013: $7,012,000). The Company has a working capital surplus of $7,205,000 as at December 31, 2014 which has decreased from the December 31, 2013 $14,213,000 surplus, as a result of cash utilized in operating activities. The Company’s accumulated deficit as at December 31, 2014 is $65,673,000 (December 31, 2013: $57,723,000).

Revenue

Revenue for the year ended December 31, 2014 was $67,104,000 as compared to $77,364,000 for the year ended December 31, 2013. Current year revenues have decreased relative to the previous year primarily as a result of a decrease in quantities and values delivered for two defence programs and one commercial business jet program, in part offset by strong current year aircraft component repairs revenue.

The Company’s production has met and continues to exceed customer quality and delivery requirements.

Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

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

FOR THE YEAR ENDED DECEMBER 31	**2014**		2013	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$ 16,324**	**24.3**	$ 22,604	29.2
Boeing	**26,122**	**38.9**	28,167	36.4
Bombardier	**12,931**	**19.3**	16,370	21.2
Other	**11,727**	**17.5**	10,223	13.2
Total	**67,104**	**100.0**	77,364	100.0

Avcorp is the single source supplier for the F-35 Carrier Variant Outboard Wing ("CV-OBW") assembly under contract with BAE Systems ("BAE"), and delivers directly to Lockheed Martin. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35 aircraft which allows for handling and storage of the aircraft on the aircraft-carrier's deck and hangers, while keeping its long-range and low-landing speed flight characteristics. The CV-OBW is regarded as one of the most complex assemblies that the Canadian aerospace industry contributes to the F-35 program.

As F-35 CV-OBW production rates flattened, and program implementation reached maturity, non-recurring start-up revenues were reduced in 2014 relative to 2013.

Shipments of large assemblies to Boeing Commercial Airplane Group ("Boeing CA"), primarily for the 737 commercial jet program, increased slightly as a result of a continued increase in customer demand during 2014, relative to 2013; while deliveries of fabricated parts remained constant. The Company also delivered components to Boeing Defense, Space & Security ("Boeing DSS") for the Chinook CH47 helicopter. The Company is currently introducing into production a new Chinook CH47 helicopter component in supply to Boeing BDS; this new program introduction will offset in 2015 a 73% decrease in revenues for this program revenue stream in 2014. The Company continues to work towards obtaining additional new contracts supporting Boeing commercial jet programs as well as other Boeing DSS defense programs.

Revenues from Bombardier Aerospace ("Bombardier") programs fell during the current year relative to the year ended December 31, 2013. Shipments of large assemblies for the CL605 business jet program decreased by 37% during the current year, while Comtek experienced a significant (38%) increase in its deliveries of composite floor panels to Bombardier. The Company's primary source of revenues from Bombardier in 2015 will continue to be from components for the CL605 and CL850 business jets, and composite floor panels for the CRJ and Q400 aircraft programs as well as production of composite floor panels in supply to Bombardier's Global 5000/6000 and Global 7000/8000 programs.

During the current year, there has been renewed customer demand for deliveries of Boeing 757 commercial jet 200 series wing adapter plugs, for retrofit to Aviation Partners Boeing, contributing to other 2014 revenues exceeding 2013 amounts. Composite aircraft structure repair revenues out of Comtek continued with a strong performance, as 2014 revenues were increased by 41% over 2013 revenues.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2014 was 7.3% of revenue as compared to 12.5% of revenue for the year ended December 31, 2013.

Gross profit as a percentage of revenues has decreased during 2014 relative to the previous year; partially as a result of comparative revenues having fallen by 13% due to changes in customer demand (December 31, 2014: $4,905,000; December 31, 2013: $9,654,000). Pricing reduction pressures from customers have contributed to reducing current year gross margins, in comparison to 2013, causing the Company's gross margin to fall by 2% of current year revenue. The continued scaling down of the plant production labour force has caused temporary production inefficiencies as existing employees progress through the learning curve associated with differing program specific production processes. These transitory production inefficiencies as well as internal quality assurance initiatives, and increased cost of US dollar denominated procured parts have adversely impacted planned 2014 margins by $1,111,000.

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $5,047,000 of overhead costs during the current year (December 31, 2013: $4,926,000) in respect of unutilized plant capacity.

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

Administration and General Expenses

As a percentage of revenue, the administration and general expenses increased to 18.4% for the year ended December 31, 2014 from 15.1% for the year ended December 31, 2013. In absolute terms, administration and general costs increased by $691,000 during the current year relative to the prior year. Personnel restructuring and incentive costs amounting to $1,581,000 were the most significant cause for the expenditure increase.

Foreign Exchange Gain or Loss

The Company recorded a $159,000 foreign exchange gain during 2014 (December 31, 2013: $1,085,000 gain) as a result of holding US dollar denominated receivables, payables and debt. Changes in the Canadian dollar equivalent of the November 16, 2012 US$27,391,000 binding arbitration award receipt was the primary cause for the foreign exchange gain recorded during the year ended December 31, 2013.

Earnings Before Interest, Taxes, Depreciation & Amortization

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

EBITDA was negative $6,129,000 for the year ended December 31, 2014 compared to a positive EBITDA of $3,241,000 for the year ended December 31, 2013. A reduction in revenues caused by changes in customer demand, for the current year, has contributed to operating losses and a resultant negative EBITDA. Significant levels of unutilized plant capacity, $5,047,000 overhead costs expensed in 2014 (December 31, 2013: $4,926,000), is the primary cause for 2014 negative EBITDA. $1,076,000 in severance and retiring allowance costs as well as $503,000 in recruitment and related compensation benefits have further eroded EBITDA in 2014 (December 31, 2013: $731,000).

EBITDA[1]

(unaudited, expressed in thousands of Canadian dollars)

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Income (loss) for the period	**$ (7,950)**	$ (1,802)
Interest expense and financing charges	**72**	927
Income tax expense	**-**	-
Depreciation	**1,601**	2,082
Amortization of development costs	**148**	2,034
	(6,129)	3,241

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

Finance Costs

Total interest and financing charges on both short- and long-term debt for the year ended December 31, 2014 was $64,000, net of $8,000 interest income (December 31, 2013: $Nil), as compared to a $927,000 expense for 2013. The decrease in interest and financing charges for 2014 is primarily as a result of the Company repaying a significant portion of its current and long-term debt during the latter part of the third and fourth quarters of 2013.

Income Taxes

The Company has not incurred a tax expense during the current year (December 31, 2013: $Nil) nor recorded a tax benefit as it is not more likely than not that the benefit would be recognized.

Income or Loss

Loss for the year ended December 31, 2014 was $7,950,000 as compared to a $1,802,000 loss for the year ended December 31, 2013. The loss for the current year relative to 2013 has increased, in-part as a result of reduced revenues on a relatively large fixed cost base of operations. The Company is actively addressing this revenue – cost imbalance. Program gross margins have diminished in 2014 relative to 2013 due to pricing concessions provided to customers, production inefficiencies caused by idle capacity, and realigning of production processes, as well as employee severance and incentive expenditures.

Liquidity and Capital Resources

The Company's operating line of credit provides for a total utilization of $12,000,000. The Company ended the current year with bank operating line utilization of $Nil compared to utilization of $Nil as at December 31, 2013. Based on net collateral provided to its bank, the Company is able to draw $4,351,000 on its operating line of credit as at December 31, 2014 (December 31, 2013: $9,016,000). The Company's banking agreement with a Canadian Chartered bank expires on September 27, 2015.

As a condition of obtaining this operating line of credit, the following term is in effect:

- A permanent block of $2,500,000 against available credit.

On March 26, 2015, the Company's bank extended its banking agreement from September 27, 2015 to March 31, 2016. As a condition to this extension in term, the bank requires that a capital injection amounting to $5,000,000 be made by September 27, 2015. If the Company does not receive this capital injection on or before September 26, 2015, then the banking agreement will expire on September 26, 2015.

On March 26, 2015, Panta Canada B.V. provided Avcorp with a commitment letter specifying indicative terms of financing for a period ending March 26, 2016. Panta Canada B.V. is 100% owned by Panta Holdings B.V., and is Avcorp's majority shareholder, owning approximately 66.1% of the Company's issued and outstanding common shares as at December 31, 2014. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

The terms upon which the Company can secure up to $5,000,000 funding from Panta Canada B.V. are as follows:

Term Loan

Panta Canada B.V. has made the commitment to Avcorp to fund the Company by way of a term loan. The Company's acceptance of this commitment is subject to a 3% commitment fee payable by the Company to Panta Canada B.V. Additionally, the term loan commitment requires the issuance of common share purchase warrants, to the maximum extent allowable, without requiring Company shareholder approval; at the market price of the Company's common shares.

The terms under which the Term Loan will be provided are as follows:

- Amount not to exceed $5,000,000;
- Twelve month term from date of execution of commitment letter;
- Early repayment is required, without penalty, from proceeds of any equity injection into the Company;

- Interest rate of 8% per year; and
- Security for the term loan will be subordinated to existing security requirements.

Non-repayment at maturity date will result in the following additional conditions:

- Interest rate will increase to 15% per year; and
- Avcorp will issue to Panta Canada B.V. common share purchase warrants, to the maximum extent allowable, without requiring Company shareholder approval at the market price for the Company's common shares.

Equity Financing

Panta Canada B.V. has made the commitment to Avcorp to underwrite a $5,000,000 equity financing to occur within twelve months following date of execution of commitment letter. The underwriting is subject to the following terms:

- 3% fee based on gross proceeds of the equity placement; and
- Maximum permissible common share price discount pursuant to TSX regulations.

On April 23, 2014, the Company announced that it has received a Strategic Aerospace and Defence Initiative ("SADI") Contribution Agreement from the Government of Canada for up to $4.4 million to support development of advanced metal bond manufacturing processes and capabilities. In particular, this SADI supported project will assist Avcorp to undertake specific capability development for large, complex metal bonded structural components, for our customers, including The Boeing Company and Cascade Aerospace. This project will also support implementation of Lean Manufacturing process improvements and advancements along our Metal Bond Technology Roadmap. This funding support from the Government of Canada will be instrumental in enabling Avcorp to achieve these capability and competitiveness enhancements in a timeframe that meets both the Company's customers' requirements and the demands of the market. The contribution amount represents 40% funding for eligible costs.

The SADI contribution agreement has the following terms:

- The maximum amount to be repaid by the Company is 1.5 times the amount contributed by the Government of Canada;
- Repayments are to occur over a 15 year term, commencing two years following the fiscal year end, in which the contributions are completed; and
- Amounts repayable are unsecured.

$760,000 was drawn on this facility as at December 31, 2014 (December 31, 2013: $Nil).

Management is actively working to secure additional production orders, has completed loan financing and renegotiated debt repayments, will continue to work with existing common shareholders, and will seek additional financing as necessary.

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital, utilized $5,829,000 of cash during the year ended December 31, 2014 as compared to providing $3,522,000 of cash during the previous year, with larger operating losses recorded in 2014 significantly contributing to the variance.

Non-cash operating assets and liabilities provided $3,034,000 of cash during the current year, compared to providing $20,506,000 of cash during the same quarter in 2013 as collection of an arbitration award receipt during 2013 provided in excess of $29,000,000 of cash. The Company continues to closely monitor accounts receivable in order to ensure cash is collected on a timely basis.

For the year ended December 31, 2014, proceeds from customer funding of program working capital amounted to $6,842,000 (December 31, 2013: $7,252,000); while deferred revenues recognized as income during the current year amounted to $10,010,000 (December 31, 2013: $17,514,000).

Cash Flows from Investing Activities

Cash proceeds received from the sale of equipment provided $589,000 of cash during the current year (December 31, 2013: $Nil). During the year ended December 31, 2014, the Company purchased capital assets totalling $1,001,000 as compared to $1,206,000 during the prior year. Equipment purchases have been made to provide for new program revenues commencing during the second half of 2014 and into 2015. The Company continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

Additionally, the Company invested $2,211,000 during the current year (December 31, 2013: $556,000) in tooling and new program introduction. Current year expenditures primarily relate to investment in the production development and introduction into the supply chain of a Ruddevator, a flight control system for stabilization and directional control of air-to-air refuelling booms for the KC-135 Tanker fleet, tooling for certain customer aircraft retro-fit programs, as well as tooling and new program introduction costs for the components on the Chinook CH47 Helicopter program.

Cash Flows from Financing Activities

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

During the current year, the Company repaid long-term debt consisting of $355,000 of equipment financing (December 31, 2013: $77,000), $132,000 of accrued government royalties (December 31, 2013: $258,000), and $36,000 of interest (December 31, 2013: $323,000). During the fourth quarter 2013, the Company repaid in full the Export Development Canada convertible debenture; the principle amount repaid during 2013 was $4,338,000.

During the current year, Avcorp redeemed Series A First Preferred Shares and paid accrued dividends amounting to $36,000 (December 31, 2013: $11,803,000).

During 2014 the Company received $760,000 (December 31, 2013: $Nil) in long-term funding under the SADI program from the Government of Canada.

During the first quarter 2014 holders of the Company's stock options exercised 1,961,000 stock options at a price of $0.05 resulting in the issuance of 1,961,000 common shares with a value of $98,000.

During the second quarter 2014 holders of the Company's stock options exercised 730,500 stock options at a price of $0.06 resulting in the issuance of 730,500 common shares with a value of $44,000.

During 2011, 19,550,532 warrants were issued having a fair value of $617,000 to Panta III B.V., who is 100% owned by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on December 31, 2014. Each warrant was exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share. All three companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

On May 13, 2014 the 19,550,532 warrants were transferred from Panta III B.V. to Panta Canada B.V.

On December 8, 2014 Panta Canada B.V. exercised 19,550,532 warrants at a price of $0.0713 per common share resulting in the issuance of 19,550,532 common shares with a value of $1,394,000.

On December 31, 2014, the ratio of the Company's current assets to current liabilities was 1.43:1 (December 31, 2013: 1.79:1), with the debt to equity ratio at 0.07:1 (December 31, 2013: 0.01:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	Total	2015	2016 – 2018	2019 – 2020	Post 2020
Finance lease obligations	**$ 473**	$ 293	$ 153	$ 28	$ -
Purchase obligations[1]	**22,649**	15,361	6,868	420	-
Other long-term obligations[2]	**763**	-	-	3	760
Total contractual obligations	**23,885**	15,654	7,020	451	760

1. Purchase obligations include payments for the Company's operating and property leases, as well as committed contractual operational purchase order obligations outstanding.
2. This amount represents obligations the Company has with Industrial Technologies Office.

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

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

Capital Stock

As at December 31, 2014, there were 302,633,184 common shares and 21,079,500 stock options issued and outstanding.

Preferred Shares

During 2013, the Company filed a notice of redemption for its Series A First Preferred Shares (the "preferred shares") notifying preferred shareholders that the preferred shares together with all dividends accrued thereon were to be paid on November 14, 2013, upon receipt of original Series A First Preferred Share Certificates at the registered offices of the Company. Preferred shares amounting to $8,134,000 along with $3,669,000 accrued dividends thereon were paid during the fourth quarter 2013. The remaining $25,000 preferred shares and $11,000 of accrued dividends were paid during the first quarter 2014. Consequently, there remain no preferred shares and accrued dividends outstanding as at the year ended December 31, 2014.

Common Shares

During the first quarter 2014 holders of the Company's stock options exercised 1,961,000 stock options at a price of $0.05 resulting in the issuance of 1,961,000 common shares with a value of $98,000.

During the second quarter 2014 holders of the Company's stock options exercised 730,500 stock options at a price of $0.06 resulting in the issuance of 730,500 common shares with a value of $44,000.

During 2011 19,550,532 warrants were issued having a fair value of $617,000 to Panta III B.V., who is 100% owned by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on December 31, 2014. Each warrant was exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share. All three companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

On May 13, 2014 the 19,550,532 warrants were transferred from Panta III B.V. to Panta Canada B.V.

On December 8, 2014 Panta Canada B.V. exercised 19,550,832 warrants at a price of $0.0713 per common share resulting in the issuance of 19,550,532 common shares with a value of $1,394,000.

During the year ended December 31, 2014, $704,000 was transferred from contributed surplus to capital stock upon exercise of stock options and warrants (December 31, 2013: $Nil).

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, issuable in series, the terms of which will be determined by the Company's directors at the time of creation of each series. There were 302,633,184 common shares issued at December 31, 2014. The book value of common shares issued and outstanding as at December 31, 2014 was $79,921,000 (December 31, 2013: $77,681,000).

Changes in Accounting Policies

The following is a brief summary of the new standard which was implemented during the current year:

IFRIC 21 – Levies

In May 2013, the IASB issued IFRIC 21 Levies, which was developed by the IFRS Interpretations Committee ("the Committee"). The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognized before the specified minimum threshold is reached.

Implementation of this standard did not have a material impact on the consolidated financial statements of the Company.

Accounting standards issued but not yet applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before February 1, 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

IFRS 15 – Revenue from Contracts with Customers

The International Accounting Standards Board ("IASB") and the US Financial Accounting Standards Board ("FASB") (collectively, "the Boards") have jointly issued a new revenue standard, IFRS 15 *Revenue from Contracts with Customers*, that will supersede virtually all revenue recognition requirements in IFRS and US GAAP.

IFRS 15 establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

This standard is required to be applied for accounting periods beginning on or after January 1, 2017, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2014 were at customer required levels for BAE, Boeing, and Bombardier programs. The Company has achieved, and continues to maintain, top quality and delivery ratings for the majority of its programs.

Order Backlog

The Company operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's agreements with Boeing Commercial Airplane Group extend from January 2013 to December 2017 and with Boeing Defense, Space and Security extending from 2013 into 2017 with established minimum base delivery quantity requirements. Agreements with BAE Systems (Operations) Limited extend to January 2016 and continue to generate additional sales order backlog. The Bombardier agreements extend for the life of the individual aircraft programs.

The Company defines order backlog as the value of purchase orders it expects to receive from these agreements based on manufacturers' projections and current degrees of exclusivity. The order backlog, as at December 31, 2014, is $185 million, ($65 million of which pertains to 2015), compared to $197 million as at December 31, 2013. The changes in order backlog are as follows:

- $67 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2014;
- $49 million increase in order backlog due to increases in the production rates and contract renewals for various existing programs, as well as recently awarded statements of work; and
- $6 million increase in order backlog resulting from change in the value of the Canadian dollar relative to the US dollar for the Company's US dollar denominated sales. Refer to comments on currency risk.

Supply Chain

Supplier quality and delivery performance continued to meet targeted levels during the year; the Company continues to monitor supplier performance in all aspects of quality, delivery and price. The Company works closely with its supply chain to ensure a stable, uninterrupted delivery of compliant products and is making changes in product sourcing processes where necessary.

During 2014 the company qualified certain suppliers in support of its in-house transition to increasingly value-added production processes. These suppliers will support the Company by providing manufacturing capabilities from which Avcorp will transition in 2015.

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 were in a surplus position of $7,205,000 at December 31, 2014 and $14,213,000 at December 31, 2013. The decrease in working capital during 2014 was primarily due to cash utilized in operating activities.

Financial Resources

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

Non-Financial Resources

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

Human Resources

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

The number of employees at December 31, 2014 was 369 (December 31, 2013: 412). Employees have appropriate qualifications and experience to perform their duties and the Company provides ongoing training and opportunities for employee growth.

Equipment, Systems, Technologies and Processes

Manufacturing equipment and information technology assets have been consistently upgraded and further deployed, increasing reliability and utility.

Risk Assessment

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

- additional financing is required to maintain and grow its business;
- no agreement on extension of customer contracts, or terminated customer programs are not replaced;
- increases in material costs, primarily aluminum plate, titanium, sandwich panels and assembly hardware, and subcontractor costs, without equivalent price protection in customer contracts;
- reduction in production rates of aircraft manufacturers and delays in program introduction;
- consolidation and globalization by competitors;
- potential failure to achieve cost-reduction objectives relative to changes in revenue levels;
- the trend to greater use of composite material in primary structures in each new generation of aircraft; and
- decrease in the value of the Canadian dollar, relative to the US dollar, has an adverse effect on the Canadian dollar equivalent value of those Company procured goods and services which are denominated in US dollars.

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

Additional Financing

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

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

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

Customer Contracts

The Company is exposed to the risk that existing customer fixed-term contracts are not renewed at expiration date. The Company's agreements with Boeing CA have been renewed and extend from January 2013 to December 2017. Agreements with Boeing DSS have been renewed and established which extend from 2013 into 2017 with minimum base quantity requirements.

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

The Company continues to face the financial risk that the wind-down in previous years of certain program contracts have not been replaced on a timely basis thereby causing the Company to continue to bear significant levels of expenses related to under-utilized operational capacity. The Company has restructured its business development strategy in order to best mitigate this risk.

Procured Materials and Parts

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

Aircraft Production Rates

The following industry and program trends impact the Company.

- Company research indicates that the aerostructures markets for commercial aircraft and larger business jets would continue to grow beyond 2014. The lighter business jets' market is expected to remain soft around current rates.
- Growth in air travel rates has and will further increase production rates on the Boeing 737 and Airbus A320 platforms in the coming years. The regional aircraft market remains soft around current rates.
- Bombardier Challenger CL605 aircraft production requirements reduced significantly in 2014 relative to 2013. The production build rate will climb moderately in 2015 and the forecast is to remain flat through 2019.
- The market for defence aircraft continued to grow into 2014, albeit at a slower pace due to general global budget challenges. Defence spending in North America and Europe is expected to decrease in the near term.
- The F-35 remains, on a global scale, one of the largest Defence Airplane programs for the foreseeable future.
- However, under the current North American Federal Governments' initiatives of cost controls regarding defence spending, there exists a risk that the customer demand for defence aircraft components is reduced or delayed.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exists to provide additional revenue from this aerospace sector.

Competitors

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

Cost Reductions

Approximately 52% of the Company's cost of sales is related to labour and overhead and 48% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its western European and north western United States competitors and higher than those in the south eastern United States, Asia, Eastern Europe and Mexico. On July 30, 2013 the Company and its labour force ratified a new six year collective agreement. The agreement was ratified by a two-thirds majority, with the new agreement expiring on March 31, 2019.

The Company continues to focus on cost reductions for direct labour, material and overhead costs. These cost reductions will be achieved through continuous improvements in the internal and external parts supply chain using lean manufacturing technology, through continued negotiation of long-term agreements with the majority of key suppliers, through increased efficiency of plant capacity augmented by technological improvements, and through continued focus on cost targets at all levels of the organization. All discretionary spending is reviewed and controlled by senior management, with expenditures focused on expediting new commercial program business growth and launching of long-term defence programs. However, fixed overhead costs continue to have an adverse impact on the Company's cost structure during this period of reduced revenues. This will be mitigated by increased revenue and facility utilization.

Composite Materials

Through its subsidiary Comtek, the Company has ongoing operations expertise in the design and competitive manufacture and repair of advanced composite aerostructures which provides the opportunity for the Company to compete in a market which is trending, with each new generation of aircraft, to greater use of composite material in primary structures. The Company continues to examine opportunities for mergers or acquisitions, on a global basis, that would acquire vertical strengths or additional strategic capabilities.

US Dollar Revenues

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. As the value of the Canadian dollar decreases, the equivalent value of US dollar denominated revenues increases; conversely, the cost of US dollar denominated purchases will increase. The Company is continuing to structure new agreements with customers which mitigate the risk associated with currency fluctuations.

Outlook

Variability of the Canadian dollar relative to the US dollar continues to cause the value of the Company's current order backlog to fluctuate. The Company continues to work towards securing additional defence programs in order to augment and diversify its backlog. The Company began delivering products under its military contracts in 2009 and continues to negotiate long-term supply agreements. Assuming long-term agreements are secured, the Company believes that revenues from its military customers will extend past 2020. The Company expects to finance investment in the start-up of new military defence programs primarily by milestone payments from customers, though this cannot be assured. The Company will require financing for capital expenditures required for new programs. Additionally, Avcorp will invest in new equipment and technological upgrades for existing equipment in order to establish composites manufacturing capabilities. Composites manufacturing capability will provide the Company with the eligibility to bid on new manufacturing projects and enter into the active resourcing and dual-sourcing aerospace composites market.

Boeing will be the Company's largest customer in 2015, followed by Bombardier and BAE. The Company forecasts its 2015 revenues to increase slightly above 2014 levels as deliveries to its existing customer base are forecasted to increase.

The Company forecasts its working capital financing requirements for 2015 to be met by the current availability of the operating line of credit. However, further debt and equity financing may be required.

Transactions with Related Parties

During the current year a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on December 31, 2014. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the year ended December 31, 2014 amounted to $1,168,000 (December 31, 2013: $690,000). Fees payable to Panta Holdings B.V. as at December 31, 2014 are $301,000 (December 31, 2013: $170,000). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $1,300,000 for the year ended December 31, 2014 (December 31, 2013: $843,000).

During the year ended December 31, 2014, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the year ended December 31, 2014 amounted to $63,000 (December 31, 2013: $81,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2014 are $20,000 (December 31, 2013: $Nil). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $83,000 for the year ended December 31, 2014 (December 31, 2013: $67,000).

Fourth Quarter

The following summarizes financial results for the fourth quarter 2014.

Operating loss for the fourth quarter of 2014 was $3,848,000 from $13,744,000 in revenues, as compared to operating loss of $2,637,000 from $17,159,000 in revenues for the quarter ended December 31, 2013. The major contributing factors for the operating loss for the fourth quarter of 2014 was deferred customer shipments, $683,000 in severance and retiring allowance costs as well as $245,000 in recruitment and related compensation benefits. The Company expensed $1,287,000 of overhead costs during the fourth quarter 2014 (2013: $1,404,000) in respect of unutilized plant capacity.

The fourth quarter 2014 operating loss is primarily attributable to reduced revenues as customers managed their inventories to reduced levels.

Cash financing was receiving during the fourth quarter 2014 from the Government of Canada under the SADI program in the amount of $760,000 (2013: $Nil).

On December 8, 2014 Panta Canada B.V. exercised 19,550,532 warrants at a price of $0.0713 per common share resulting in the issuance of 19,550,532 common shares with a value of $1,394,000.

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

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

Proposed Transactions

As at the date of this report, no agreements to merge with or acquire another entity have been entered into.

Critical Accounting Estimates and Judgment

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

- Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.
- Carrying value of long-lived assets: The Company holds property, plant and equipment, on the consolidated statements of financial position amounting to $8,204,000 (December 31, 2013: $8,704,000). The recoverability of these assets is dependent on the ability of the Company to generate sufficient cash flow from operations over the remaining useful life of the assets, which is contingent on, amongst other factors, the ability of the Company to replace known program losses with new programs as well as ramping up scheduled production for new production contracts. The recoverability of the carrying value of these assets is, in part, dependent on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on delivering to the scheduled production ramp-up for new programs, as well as dependent on market conditions including demand for such aircraft for which the Company provides its products.
- Recoverability of deferred tooling costs: The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations as well as contractually required payments by customers. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2014, $3,303,000 (December 31, 2013: $1,240,000) in unamortized deferred tooling costs, which are expected to have a future economic benefit, are presented as Development costs in the consolidated statements of financial position. Development costs of $569,000 (December 31, 2013: $585,000) are internally generated and not supported by customer advances.
- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The December 31, 2014 provision for anticipated losses was $190,000 (December 31, 2013: $51,000). The increase in this provision from December 31, 2013 was primarily as a result of production inefficiencies caused by a re-distribution within customer programs of the plant workforce arising from employee lay-offs.
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $5,047,000 of overhead costs during the current year (December 31, 2013: $4,926,000) in respect of unutilized plant capacity.

Financial Instruments and Other Instruments

Interest rate risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 0.5%. The maximum operating line of credit availability is $12,000,000 of which $Nil is utilized as at December 31, 2014 (December 31, 2013: $Nil). 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, 2014, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2013: $Nil) impact on net earnings and cash flow.

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

Currency risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange gain recorded in 2014 was $159,000 as compared to a $1,085,000 gain for the year ended December 31, 2013.

The Company had the following US dollar denominated balances:

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Bank cash position	**$ 1,645**	$ 2,350
Accounts receivable	**2,314**	4,750
Accounts payable net of prepayments	**1,901**	1,109

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in an increase (decrease) of approximately $206,000 in net income for the year ended December 31, 2014 (December 31, 2013: $599,000 increase (decrease) in net income as a result of holding a US dollar net asset position.

Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group ("Boeing"), Boeing Defense, Space & Security ("BDS"), Bombardier Aerospace ("Bombardier") and BAE Systems (Operations) Limited ("BAE"). During 2014 and 2013, there were no trade receivables written off by the Company in respect of these customers. The maximum exposure to credit risk is represented by the amount of accounts receivable in the consolidated statements of financial position.

As at the consolidated statements of financial position date 74.6% (December 31, 2013: 80.4%) of the Company's trade accounts receivable are attributable to these customers.

Liquidity Risk

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

Capital Risk

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

The Company includes long-term debt, preferred shares and capital stock in its definition of capital, as shown in the Company's consolidated statements of financial position.

The Company's primary objective in its management of capital is to ensure that it has sufficient financial resources to fund ongoing operations and new program investment. In order to secure this capital the Company may attempt to raise funds via issuance of debt and equity, or by securing strategic partners.

Other Items

Disclosure Controls and Procedures, and Internal Controls over Financial Reporting

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

The Chief Executive Officer and the Vice President, Finance, have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of December 31, 2014 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, 2014, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

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

report of **management**

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

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

	EDWARD M. MERLO Vice President, Finance and Corporate Secretary		**PETER GEORGE** Executive Officer and Group Chief Executive Officer

report of **auditors**

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Avcorp Industries Inc.

We have audited the accompanying consolidated financial statements of Avcorp Industries Inc., which comprise the consolidated statements of financial position as at December 31, 2014 and 2013, and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Avcorp Industries Inc. as at December 31, 2014 and 2013, and of its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

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

Vancouver, British Columbia
March 31, 2015

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

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

AS AT DECEMBER 31	**2014**	2013
ASSETS		
Current assets		
Cash (note 13)	**$ 3,159**	$ 7,012
Accounts receivable (note 9)	**5,642**	8,845
Inventories (note 10)	**13,738**	14,940
Prepayments and other assets	**1,290**	1,306
	23,829	32,103
Non-current assets		
Prepaid rent	**146**	146
Development costs (note 11)	**3,303**	1,240
Property, plant and equipment (note 12)	**8,204**	8,704
Total assets	**35,482**	42,193
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 14)	**8,549**	7,645
Current portion of long-term debt (note 17)	**293**	199
Preferred shares (note 20)	**-**	36
Deferred program revenues (note 15)	**7,782**	10,010
	16,624	17,890
Non-current liabilities		
Deferred gain (note 16)	**168**	216
Lease inducement (note 16)	**370**	469
Long-term debt (note 17)	**943**	67
	18,105	18,642
Equity		
Capital stock (note 19)	**79,921**	77,681
Contributed surplus (note 19)	**3,129**	3,593
Deficit	**(65,673)**	(57,723)
	17,377	23,551
Total liabilities and equity	**35,482**	42,193

Nature of operations (note 1)
Critical accounting estimates and judgements (note 4)
Obligations and commitments under finance and operating leases (note 18)
Subsequent events (note 29)

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

Approved by the Board of Directors on March 31, 2015

David Levi
Chairman

Eric Kohn TD
Committee Chair,
Audit & Corporate Governance Committee

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

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

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Revenues	**$ 67,104**	$ 77,364
Cost of sales	**62,199**	67,710
Gross profit	**4,905**	9,654
Administrative and general expenses	**12,373**	11,682
Office equipment depreciation	**570**	591
Other operating (income)	**-**	(604)
Operating (Loss)	**(8,038)**	(2,015)
Finance costs – net (note 23)	**64**	927
Foreign exchange (gain)	**(159)**	(1,085)
Loss (gain) on disposal of equipment (note 12)	**3**	(108)
Write-down of equipment (note 12)	**4**	53
(Loss) Income before income tax	**(7,950)**	(1,802)
Income tax expense (note 25)	**-**	-
(Loss) Income and total comprehensive (loss) income for the period	**(7,950)**	(1,802)
(Loss) Earnings per share:		
Basic (loss) earnings per common share (note 27)	**(0.03)**	(0.01)
Diluted (loss) earnings per common share (note 27)	**(0.03)**	(0.01)
Basic weighted average number of shares outstanding (000's) (note 27)	**284,052**	271,380
Diluted weighted average number of shares outstanding (000's) (note 27)	**284,052**	271,380

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
(prepared in accordance with IFRS, expressed in thousands of Canadian dollars)

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Cash flows from (used in) operating activities		
(Loss) Income before income tax	**$ (7,950)**	$ (1,802)
Adjustment for items not affecting cash:		
Accrued interest and government royalties	**38**	270
Depreciation	**1,601**	2,082
Development cost amortization	**148**	2,034
Loss (gain) on disposal of equipment	**3**	(108)
Preferred share dividends accrued	**-**	657
Provision for loss-making contracts	**139**	51
Provision for obsolete inventory	**60**	335
Stock based compensation	**240**	54
Warranty provision	**-**	(85)
Write-down of equipment	**4**	53
Other items	**(112)**	(19)
	(5,829)	3,522
Changes in non-cash working capital		
Accounts receivable	**4,466**	2,121
Inventories	**1,003**	1,246
Prepayments and other assets	**(7)**	326
Other receivable	**-**	27,391
Accounts payable and accrued liabilities	**740**	(316)
Deferred program revenues (note 15)	**(3,168)**	(10,262)
Net cash from (used in) operating activities	**(2,795)**	24,028
Cash flows from (used in) investing activities		
Proceeds from sale of equipment	**589**	-
Purchase of equipment	**(1,001)**	(1,206)
Payments relating to development costs and tooling	**(2,211)**	(556)
Net cash from (used in) investing activities	**(2,623)**	(1,762)
Cash flows from (used in) financing activities		
Decrease in bank indebtedness	**-**	(2,122)
Payment of interest	**(36)**	(323)
Proceeds from long term debt	**760**	-
Proceeds from issuance of common shares	**1,536**	1,249
Redemption of preferred shares and accrued dividends	**(36)**	(11,803)
Repayment of current and long-term debt	**(355)**	(4,415)
Repayment of government royalties	**(132)**	(258)
Net cash from (used in) financing activities	**1,737**	(17,672)
Net increase (decrease) in cash	**(3,681)**	4,594
Net foreign exchange difference	**(172)**	(179)
Cash - Beginning of period	**7,012**	2,597
Cash - End of period	**3,159**	7,012

Supplementary Cash Flow Information (note 24)

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

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

	Share capital				
	Shares	**Amount**	**Contributed surplus**	**Deficit**	**Total equity**
Balance December 31, 2012	254,898,072	$ 76,423	$ 3,539	$ (55,921)	$ 24,041
Issue of common shares (notes 19d and e)	25,493,080	1,258	-	-	1,258
Stock based compensation expense (notes 19g and 21)	-	-	54	-	54
Loss for the period	-	-	-	(1,802)	(1,802)
Balance December 31, 2013	280,391,152	77,681	3,593	(57,723)	23,551
Issue of common shares (notes 19a, b and c)	22,242,032	1,536	-	-	1,536
Stock-based compensation expense (notes 19g and 21)	-	-	240	-	240
Transfer to share capital on exercise of stock options and warrants (note 19g)	-	704	(704)	-	-
Loss for the period	-	-	-	(7,950)	(7,950)
Balance December 31, 2014	**302,633,184**	**79,921**	**3,129**	**(65,673)**	**17,377**

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

1. Nature of Operations

Avcorp Industries Inc. (the "Company" or "Avcorp") is a Canadian-based manufacturer within the aerospace industry, and a single source supplier for engineering design, manufacture and assembly of subassemblies and complete major structures for aircraft manufacturers.

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

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

The consolidated financial statements of the Company for the year ended December 31, 2014 were authorized for issue in accordance with a resolution of its Board of Directors on March 31, 2015.

2. Basis of Preparation and Measurement

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

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

3. Summary of Significant Accounting Policies

The significant accounting policies used in the preparation of these consolidated financial statements are described below. These policies have been consistently applied to all periods presented, unless otherwise stated.

Basis of consolidation

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

The consolidated financial statements comprise the financial statements of the Group and its subsidiary as at December 31, 2014. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights result in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee;
- Rights arising from other contractual arrangements; and
- The Group's voting rights and potential voting rights.

The Group re-assesses whether or not it controls and investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, oncome and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income ("OCI") are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this result in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognizes the related assets (including goodwill), liabilities, non-controlling interest and other components of equity while any resultant gain or loss is recognized in profit or loss. Any investment retained is recognized at fair value.

Foreign currency translation

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

Fair value measurement

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

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

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

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

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

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

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

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

Financial instruments

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

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

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

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

  Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of income. Gains and losses arising from changes in fair value are presented in the consolidated statement of income, in the period in which they arise, within administrative and general expenses as amounts are not material. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the consolidated statements of financial position date, which is classified as non-current.

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

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

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

Inventories

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

Property, plant and equipment

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

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

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

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

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

Impairment of non-financial assets

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

Employee benefits

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

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

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

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

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

Provisions

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

Revenue

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

Revenue is measured based on the price specified in the sales contract, net of discounts.

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

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

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

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

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

Cost of sales

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

Income tax

a) Current income tax

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

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

b) Deferred tax

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

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

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

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

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

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

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

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

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

Share capital

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

Dividends

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

Earnings per share

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

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

Research and development costs

Research costs are expensed as incurred. Development costs, which are currently all tooling and new program introduction costs incurred on long-term programs that meet the criteria for deferral, are capitalized and amortized straight-line over the contract period or over the number of shipsets management believes is a reasonable estimate of units to be sold for the program.

Government assistance

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

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

Leases

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

Changes in Accounting Policies

The following is a brief summary of the new standard which was implemented during the current year:

IFRIC 21 – Levies

In May 2013, the IASB issued IFRIC 21 Levies, which was developed by the IFRS Interpretations Committee ("the Committee"). The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognized before the specified minimum threshold is reached.

Implementation of this standard did not have a material impact on the consolidated financial statements of the Company.

Accounting standards issued but not yet applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before February 1, 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

IFRS 15 – Revenue from Contracts with Customers

The International Accounting Standards Board ("IASB") and the US Financial Accounting Standards Board ("FASB") (collectively, "the Boards") have jointly issued a new revenue standard, IFRS 15 *Revenue from Contracts with Customers*, that will supersede virtually all revenue recognition requirements in IFRS and US GAAP.

IFRS 15 establishes principles to address the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

This standard is required to be applied for accounting periods beginning on or after January 1, 2017, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

4. Critical Accounting Estimates and Judgements

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

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

- Carrying value of long-lived assets: The Company holds property, plant and equipment, (note 12) on the consolidated statements of financial position amounting to $8,204,000 (December 31, 2013: $8,704,000). The recoverability of these assets is dependent on the ability of the Company to generate sufficient cash flow from operations over the remaining useful life of the assets, which is contingent on, amongst other factors, the ability of the Company to replace known program losses with new programs as well as ramping up scheduled production for new production contracts. The recoverability of the carrying value of these assets is, in part, dependent on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on delivering to the scheduled production ramp-up for new programs, as well as dependent on market conditions including demand for such aircraft for which the Company provides its products.

- Recoverability of deferred tooling costs: The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations as well as contractually required payments by customers. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At December 31, 2014, $3,303,000 (December 31, 2013: $1,240,000) in unamortized deferred tooling costs (note 11), which are expected to have a future economic benefit, are presented as Development costs in the consolidated statements of financial position.

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

Development costs of $569,000 (December 31, 2013: $585,000) are internally generated and not supported by customer advances.

- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The December 31, 2014 provision for anticipated losses was $190,000 (December 31, 2013: $51,000). The increase in this provision from December 31, 2013 was primarily as a result of production inefficiencies caused by a re-distribution within customer programs of the plant workforce arising from employee lay-offs.
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $5,047,000 of overhead costs during the current year (December 31, 2013: $4,926,000) in respect of unutilized plant capacity. These amounts are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales.
- Deferred program revenues are recognized as revenue straight-line over the contract period; or on a units-of-production basis over the expected life of the program, where expected life is an estimate based on customer and industry data; or as non-recurring activities are completed.

5. Expenses by Nature

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

Expenses by nature:

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Salary, wages and benefits	**$ 31,849**	$ 34,356
Raw materials, purchased parts and consumables	**29,104**	30,066
Rent	**2,548**	2,505
Contracted services and consulting	**2,186**	1,667
Other expenses	**1,667**	1,938
Depreciation	**1,601**	2,082
Guarantee fees	**1,300**	843
Utilities	**1,100**	1,063
Transportation	**808**	846
Office equipment rental/maintenance	**678**	583
Travel costs	**677**	559
Legal and audit fees	**459**	422
Insurance	**401**	438
Plant equipment rental and maintenance	**390**	360
Royalties	**226**	221
Amortization of development costs	**148**	2,034
	75,142	79,983

6. Capital Risk Management

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

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

The Company includes long-term debt, preferred shares and capital stock in its definition of capital, as shown in the Company's consolidated statements of financial position.

The Company's primary objective in its management of capital is to ensure that it has sufficient financial resources to fund ongoing operations and new program investment. In order to secure this capital the Company may attempt to raise funds via issuance of debt and equity, or by securing strategic partners.

7. Financial Risk Management

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

a) Currency Risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange gain recorded in 2014 was $159,000 as compared to a $1,085,000 gain for the year ended December 31, 2013.

The Company had the following US dollar denominated balances:

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Bank cash position	**$ 1,645**	$ 2,350
Accounts receivable	**2,314**	4,750
Accounts payable net of prepayments	**1,901**	1,109

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in an increase (decrease) of approximately $206,000 in net income for the year ended December 31, 2014 (December 31, 2013: $599,000 increase (decrease) in net income as a result of holding a US dollar net asset position.

b) Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group ("Boeing"), Boeing Defense, Space & Security ("BDS"), Bombardier Aerospace ("Bombardier") and BAE Systems (Operations) Limited ("BAE"). During 2014 and 2013, there were no trade receivables written off by the Company in respect of these customers. The maximum exposure to credit risk is represented by the amount of accounts receivable in the consolidated statements of financial position.

As at the consolidated statements of financial position date 74.6% (December 31, 2013: 80.4%) of the Company's trade accounts receivable are attributable to these customers.

c) Liquidity Risk

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

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

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

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

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

				December 31, 2014
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness	$ -	$ -	$ -	$ -
Long-term debt	78	215	183	760
Trade payables	3,725	-	-	-

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

d) Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 0.5%. The maximum operating line of credit availability is $12,000,000 (note 13) of which $Nil is utilized as at December 31, 2014 (December 31, 2013: $Nil). 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, 2014, with other variables unchanged, a 1% change in the bank prime interest rate would have a $Nil (December 31, 2013: $Nil) impact on net earnings and cash flow.

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

e) Price Risk

Certain of the Company's contracts contain derivative financial instruments to reduce exposure to price risk associated with its revenues and costs of certain procured items.

Sales Contracts

A number of the Company's sales contracts have a price adjustment clause where the final sales price is determined by certain indices in a period prior to the date of sale. As a result, the final sales price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded within administrative and general expenses, as amounts are not material, until the date of sale. As at December 31, 2014, the Company has $5,554,000 (December 31, 2013: $11,777,000) of firmly committed orders that include price adjustment clauses of this nature. $20,000 has been recorded as a derivative loss for the year ended December 31, 2014 as compared to a $2,000 gain for the year ended December 31, 2013 as a result of the change in the fair value of the underlying embedded derivatives.

Purchase Contracts

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

Included in prepayments and other assets is $3,000 of inflation derivatives assets arising from the Company's sales contracts having price adjustment clauses within their terms (December 31, 2013: $25,000).

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

f) Financial Assets and Liabilities by Category

As at December 31, 2014 and 2013, the Company's financial assets and liabilities are categorized as follows:

				December 31, 2014
	Loans and receivables	Held at fair value	Financial assets and liabilities at amortized cost	Total
Financial Assets				
Accounts receivable	$ 5,642	$ -	$ -	$ 5,642
Commodity contracts	-	3	-	3
Financial Liabilities				
Accounts payable and accrued liabilities	-	-	8,549	8,549
Long-term debt	-	-	1,236	1,236

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

g) Fair values

The fair values of the Company's accounts receivable, accounts payable and accrued liabilities are estimated to approximate their carrying values due to their immediate or short-term maturity. A portion of the Company's long-term debt is held with Industrial Technologies Office, which is a governmental body. The remaining long-term debt is in the form of finance leases which will be re-paid within five years, and fair value is not materially different from the value recorded.

8. Fair Value Measurement

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

				December 31, 2014
	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets not measured at fair value:				
Accounts receivable	$ 5,642	$ -	$ -	$ 5,642
Liabilities not measured at fair value:				
Accounts payable and accrued liabilities	8,549	-	-	8,549
Long-Term debt	1,236	-	-	1,236

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

				December 31, 2013
	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets not measured at fair value:				
Accounts receivable	$ 8,845	$ -	$ -	$ 8,845
Liabilities not measured at fair value:				
Accounts payable and accrued liabilities	7,645	-	-	7,645
Long-term debt	266	-	-	266
Preferred shares	36	-	-	36

9. Accounts Receivable

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Trade receivables	**$ 5,214**	$ 8,505
Input tax credits	**332**	166
Accrued receivables	**96**	174
	5,642	8,845

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

FOR THE YEAR ENDED DECEMBER 31	2014	2013
US dollar	**US $2,314**	US $4,750
Canadian dollar	**2,958**	3,793

10. Inventories

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Raw materials	**$ 5,287**	$ 5,005
Work-in-progress	**6,448**	9,203
Finished products	**2,003**	732
	13,738	14,940

The amount of inventory expensed in cost of sales during the year ended December 31, 2014 amounted to $57,004,000 (December 31, 2013: $60,750,000). The carrying value of inventory pledged as security as at December 31, 2014 is $13,738,000 (December 31, 2013: $14,940,000).

On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The December 31, 2014 provision for anticipated losses was $190,000 (December 31, 2013: $51,000). Work in progress inventory noted in the above table has been presented net of these provisions for anticipated losses. Certain program inventories have been funded by a customer, whereby the associated deferred program revenues will be recorded as revenue upon delivery of units of production.

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

11. Development Costs

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

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Opening balance	**$ 1,240**	$ 2,718
Additions	**2,211**	556
Realized and amortization	**(148)**	(2,034)
	3,303	1,240

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Cost	**$ 6,420**	$ 4,209
Accumulated amortization	**(3,117)**	(2,969)
Net book amount	**3,303**	1,240

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

12. Property, Plant and Equipment

	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
Year ended December 31, 2013				
Opening net book amount	$ 7,618	$ 1,519	$ 496	$ 9,633
Additions	506	670	30	1,206
Disposals – cost	(1,074)	(18)	-	(1,092)
Disposals – accumulated depreciation	1,021	18	-	1,039
Depreciation charge	(1,444)	(550)	(88)	(2,082)
Closing net book amount	6,627	1,639	438	8,704
At December 31, 2013				
Cost	29,319	7,399	944	37,662
Accumulated depreciation	(22,692)	(5,760)	(506)	(28,958)
Net book amount	6,627	1,639	438	8,704
Year ended December 31, 2014				
Opening net book amount	6,627	1,639	438	8,704
Additions	1,350	104	242	1,696
Disposals – cost	(1,111)	(72)	(26)	(1,209)
Disposals – accumulated depreciation	515	73	26	614
Depreciation charge	(856)	(540)	(205)	(1,601)
Closing net book amount	6,525	1,204	475	8,204
At December 31, 2014				
Cost	29,558	7,431	1,160	38,149
Accumulated depreciation	(23,033)	(6,227)	(685)	(29,945)
Net book amount	6,525	1,204	475	8,204

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

The Company has $471,000 in commitments at December 31, 2014 to purchase property, plant and equipment in 2015.

Included in computer hardware and software are assets held under finance leases at a cost of $939,000 (December 31, 2013: $220,000) having accumulated depreciation of $164,000 (December 31, 2013: $91,000).

Included in machinery and equipment are assets held under finance leases at a cost of $117,000 (December 31, 2013: $Nil) having accumulated depreciation of $1,000 (December 31, 2013: $Nil).

During 2014, the value of certain machinery, equipment and tooling after consideration of $29,000 was written down by $4,000 (December 31, 2013: $53,000). The equipment which was no longer in use had a cost of $548,000 (December 31, 2013: $186,000), and an accumulated depreciation of $515,000 (December 31, 2013: $133,000); resulting in a $33,000 charge against income.

13. Bank Indebtedness

On September 27, 2012 the Company entered into a loan agreement with a Canadian chartered bank for a $12 million principal amount secured debt facility. The debt facility has a three-year term (note 29b) and bears interest at a rate equal to the bank's prime rate plus 0.5%.

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

As a condition of obtaining this operating line of credit, the following term is in effect:

- A permanent block of $2,500,000 against available credit.

As at December 31, 2014, the Company had drawn $Nil (December 31, 2013: $Nil) on this debt facility offset by $3,159,000 cash (December 31, 2013: $7,012,000 cash), providing a net cash position of $3,159,000 (December 31, 2013: $7,012,000 cash). Based on net collateral provided to its bank, the Company is able to draw $4,351,000 on its operating line of credit as at December 31, 2014 (December 31, 2013: $9,016,000).

14. Accounts Payable and Accrued Liabilities

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Trade payables	**$ 3,725**	$ 3,543
Payroll-related liabilities	**2,633**	2,712
Restructuring provision	**1,055**	555
Other	**1,136**	835
	8,549	7,645

15. Deferred Program Revenues

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Opening balance	**$ 10,010**	$ 17,514
Additions	**14,196**	15,441
Realized	**(16,424)**	(22,945)
	7,782	10,010

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

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

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

16. Deferred Gain, Lease Inducement and Prepaid Rent

On July 17, 2003, the Company sold its land and building for gross proceeds of $16,000,000, representing $14,500,000 received in cash for the property and $1,500,000 as a lease inducement credit. Concurrently, the Company entered into a 15-year leaseback agreement with the purchaser of the property. A $712,000 gain arising on disposal of property in 2003 was recorded as a deferred gain and is being amortized to income over the life of the lease. The unamortized balance of the gain is $168,000 as at December 31, 2014 (December 31, 2013: $216,000). The amount of prepaid rent the Company has as at December 31, 2014 is $146,000 (December 31, 2013: $146,000).

Concurrent with the sale and leaseback transaction recorded in 2003, the Company recorded a lease inducement credit of $1,500,000. The lease inducement credit is being amortized against rental expense over the term of the lease. It has an unamortized balance of $370,000 as at December 31, 2014 (December 31, 2013: $469,000).

17. Long-Term Debt

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Finance leases (a)	**$ 473**	$ 132
Accrued government royalties (b)	**-**	134
SADI (c)	**763**	-
	1,236	266
Less: Current portion	**(293)**	(199)
	943	67

a) Finance Leases

There are various equipment leases that have a weighted average interest rate of 8.08% per annum. The leases are secured by way of a charge against specific assets. The leases are repayable in equal installments over periods up to 60 months.

b) Accrued Government Royalties

Royalties applicable on certain contracts payable to Industrial Technologies Office were paid during the second quarter 2014. No further amounts are owed.

c) SADI

On April 23, 2014, the Company secured funding for certain non-recurring expenditures and manufacturing equipment. The Government of Canada under the Strategic Aerospace and Defence Initiative (“SADI”) program has committed up to $4.4 million for funding of program eligible costs. The contribution amount represents 40% funding for eligible costs.

The contribution agreement has the following terms:

- The maximum amount to be repaid by the Company is 1.5 times the amount contributed by the Government of Canada;
- Repayments are to occur over a 15 year term, commencing two years following the fiscal year end, in which the contributions are completed; and
- Amounts repayable are unsecured.

$763,000 was drawn on this facility as at December 31, 2014.

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

18. Obligations and Commitments Under Finance and Operating Leases

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

FOR THE YEAR ENDED DECEMBER 31	**2014**		2013	
	Operating	**Finance**	Operating	Finance
2014			2,706	75
2015	**2,681**	**319**	2,723	59
2016	**2,682**	**117**	2,622	12
2017	**2,671**	**26**	2,622	-
2018	**1,484**	**26**	1,459	-
2019	**296**	**28**	296	-
Thereafter	**124**	**-**	124	-
Total future minimum lease payments	**9,938**	**516**	12,552	146
Less: Imputed interest	**n/a**	**(43)**	n/a	(14)
Balance of obligation under finance leases included in long-term debt (note 18b)	**n/a**	**473**	n/a	132

For the year ended December 31, 2014, an amount of $2,639,000 representing payments under operating leases was expensed (December 31, 2013: $2,671,000).

As at December 31, 2014 the Company had $12,651,000 of committed contractual operational purchase order obligations outstanding (December 31, 2013: $12,634,000).

19. Capital Stock

Authorized

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

Common shares issued or reserved:

	Number of shares	**Amount**
December 31, 2012	254,898,072	$ 76,423
Share issue		
Cash (d)	25,489,807	1,249
Non-cash (e)	3,273	9
December 31, 2013	280,391,152	77,681
Share issue		
Cash (a,b and c)	22,242,032	1,536
Transfer to share capital on exercise of stock options and warrants (c)	-	704
December 31, 2014	302,633,184	79,921

a) During the first quarter 2014 holders of the Company's stock options exercised 1,961,000 stock options at a price of $0.05 resulting in the issuance of 1,961,000 common shares with a value of $98,000.

b) During the second quarter 2014 holders of the Company's stock options exercised 730,500 stock options at a price of $0.06 resulting in the issuance of 730,500 common shares with a value of $44,000.

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

c) During 2011 19,550,532 warrants were issued having a fair value of $617,000 to Panta III B.V., who is 100% owned by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on December 31, 2014. Each warrant was exercisable on or before January 1, 2015 with respect to one common share at an exercise price of $0.0713 per common share. All three companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

On May 13, 2014 the 19,550,532 warrants were transferred from Panta III B.V. to Panta Canada B.V.

On December 8, 2014 Panta Canada B.V. exercised 19,550,532 warrants at a price of $0.0713 per common share resulting in the issuance of 19,550,532 common shares with a value of $1,394,000.

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

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

f) The Company's incentive stock option plan is administered by the Board of Directors. It is a rolling share option plan wherein 10% of the issued and outstanding common shares at the time an option is granted are reserved for issuance. During 2014 the Company granted 5,600,000 stock options pursuant to section 613(c) of the TSX Company Policy Manual.

A summary of the Company's stock options issued as of December 31, 2014 and December 31, 2013, and changes during the periods ending on those dates, are presented below.

FOR THE YEAR ENDED DECEMBER 31		**2014**		2013
	Options	**Weighted average exercise price**	Options	Weighted average exercise price
Outstanding – Beginning of year	**10,535,500**	**$ 0.05**	11,266,000	$ 0.05
Granted	**24,255,000**	**0.10**	-	-
Forfeited	**(624,500)**	**0.05**	(730,500)	0.05
Exercised	**(2,691,500)**	**0.05**	-	-
Outstanding – End of year	**31,474,500**	**0.09**	10,535,500	0.05

The following table summarizes stock options outstanding and exercisable as at December 31, 2014:

	Number	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**
$0.05 - $0.10	31,474,500	7.69	$ 0.09

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

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Beginning of year	**$ 3,593**	$ 3,539
Stock-based compensation expense	**240**	54
Transfer of share capital on exercise of stock options and warrants	**(704)**	-
End of year	**3,129**	3,593

The stock-based compensation expense is included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amounts to $240,000 (December 31, 2013: $54,000).

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

20. Preferred Shares

During 2013, the Company filed a notice of redemption for its Series A First Preferred Shares (the "preferred shares") notifying preferred shareholders that the preferred shares together with all dividends accrued thereon were to be paid on November 14, 2013, upon receipt of original Series A First Preferred Share Certificates at the registered offices of the Company. Preferred shares amounting to $8,134,000 along with $3,669,000 accrued dividends thereon were paid during the fourth quarter 2013. The remaining $25,000 preferred shares and $11,000 of accrued dividends were paid during the first quarter 2014. Consequently, there remain no preferred shares and accrued dividends outstanding as at the year ended December 31, 2014.

21. Stock Based Compensation

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

The fair value of 24,255,000 options granted during the year ended December 31, 2014 was $1,738,000 (December 31, 2013: $Nil).

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

	24,255,000 Options
Risk-free rate (%)	1.10
Dividend yield (%)	-
Expected Lives (years)	10
Volatility (%)	80.29

The amount of stock-based compensation expense, for options granted in current and prior periods, amortized to earnings during the year ended December 31, 2014 was $240,000 (2013: $54,000). Stock-based compensation expense has been included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses.

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

22. Defined Contribution Plan

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

FOR THE YEAR ENDED DECEMBER 31	**2014**	2013
Defined contribution plan	**$ 1,305**	$ 1,403

The Company's contribution to the plan is calculated on a percentage of employee wages. The range of percentages is 1.5% to 9.5%. The plan is available to all employees. Defined contribution plan expenses have been included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and cost of sales.

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

23. Finance Costs

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Interest on finance leases	**$ 27**	$ 15
Interest on other long-term debt	**11**	167
Interest on short-term debt	**34**	88
Preferred share dividends accrued	**-**	657
Interest expense	**72**	927
Interest income	**(8)**	-
Net interest expense	**64**	927

24. Supplementary Cash Flow Information

Non-cash financing and investing activities:

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Conversion of preferred shares	**$ -**	$ 9
Uncollected deferred tooling revenue	**940**	2,759
Assets acquired under finance lease	**695**	-

25. Income Tax

The provision for income tax (recovery) expense is based on the combined federal and provincial annual income tax rate expected for the full financial year of 26.00%. The tax rate has increased by 0.25% from December 31, 2013 due to a provincial corporate tax rate increase.

Deferred tax assets are recognized for deductible temporary differences, unused tax losses, and unused tax credits to the extent that the realization of the related tax benefit through future taxable profits is probable. The Company did not recognize deferred income tax assets of $16,925,000 (2013: $14,650,000) in respect of losses amounting to $27,390,000 (2013: $20,276,000) which expire beginning in 2025 through 2034, unclaimed research and development costs of $10,830,000 (2013: $10,830,000) with no expiry, investment tax credits of $1,597,000 (2013: $1,597,000) which expire beginning in 2016 through 2032, and deductible temporary differences of $21,894,000 (2013: $20,252,000).

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Statutory tax rate	**26.00%**	25.75%
Recovery at statutory rate	**$ (2,067)**	$ (464)
Adjustments of provision to tax return	**(201)**	(191)
Change in unrecognized deferred tax assets	**2,194**	936
Benefit of losses not previously recognized	**-**	(477)
Non-deductible preferred share dividends	**-**	169
Other permanent differences	**74**	27
Tax expense	**-**	-

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

26. Related Party Transactions

a) During the current year a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on December 31, 2014. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the year ended December 31, 2014 amounted to $1,168,000 (December 31, 2013: $690,000). Fees payable to Panta Holdings B.V. as at December 31, 2014 are $301,000 (December 31, 2013: $170,000). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $1,300,000 for the year ended December 31, 2014 (December 31, 2013: $843,000).

b) During the year ended December 31, 2014, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the year ended December 31, 2014 amounted to $63,000 (December 31, 2013: $81,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2014 are $20,000 (December 31, 2013: $Nil). These fees are included in the Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $83,000 for the year ended December 31, 2014 (December 31, 2013: $67,000).

c) Key management compensation

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

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Salaries and other short-term employee benefits	**$ 952**	$ 809
Contributions to defined contribution plan	**34**	41
Option-based awards	**245**	4
	1,231	854

d) Loans to related parties

The balance of loans receivable from key management as at December 31, 2014 is $15,000 (December 31, 2013: $15,000).

Other related party transactions are disclosed elsewhere in these consolidated financial statements (notes 19c, d and 29a).

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

27. Earnings per share

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

Diluted earnings per share amounts are calculated by dividing the net profit attributable to common equity holders of the parent by the weighted average number of common shares outstanding during the year plus the weighted average number of common shares that would be issued on conversion of all the dilutive potential common shares into common shares.

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

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

FOR THE YEAR ENDED DECEMBER 31	2014	2013
Weighted average number of common shares for basic earnings per share	**284,052**	271,380
Effect of dilution:		
Share options	**-**	-
Weighted average number of ordinary shares adjusted for the effect of dilution	**284,052**	271,380

There have been no other transactions involving common shares or potential common shares between the reporting date and the date of authorization of these consolidated financial statements.

28. Economic Dependence and Segmented Information

a) Sales to three major customers for the year ended December 31, 2014, which comprise several programs and contracts, accounted for approximately 82.5% (December 31, 2013: 86.8%) of sales.

FOR THE YEAR ENDED DECEMBER 31	2014		2013	
	Revenue	% of Total	Revenue	% of Total
BAE Systems	**$ 16,324**	**24.3**	$ 22,604	29.2
Boeing	**26,122**	**38.9**	28,167	36.4
Bombardier	**12,931**	**19.3**	16,370	21.2
Other	**11,727**	**17.5**	10,223	13.2
Total	**67,104**	**100.0**	77,364	100.0

b) The Company's sales are distributed amongst the following geographical locations:

	2014	%	2013	%
Canada	**$ 17,181**	**25.6**	$ 21,055	27.2
USA	**30,365**	**45.3**	31,089	40.2
Europe	**17,905**	**26.7**	23,533	30.4
Asia	**1,360**	**2.0**	1,375	1.8
Australia	**254**	**0.4**	256	0.3
Other	**39**	**0.0**	56	0.1
	67,104	**100.0**	77,364	100.0

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

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

FOR THE YEAR ENDED DECEMBER 31	2014		2013	
	Revenue	% of Total	Revenue	% of Total
Avcorp Industries Inc.	**$ 53,751**	**80.1**	$ 66,707	86.2
Comtek Advanced Structures Ltd.	**13,353**	**19.9**	10,657	13.8
Total	**67,104**	**100.0**	77,364	100.0

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

FOR THE YEAR ENDED DECEMBER 31	2014		2013	
	Income (loss)	**% of Total**	Income (loss)	% of Total
Avcorp Industries Inc.	**$ (8,038)**	**100.0**	$ (834)	46.3
Comtek Advanced Structures Ltd.	**88**	**-**	(968)	53.7
Total	**(7,950)**	**100.0**	(1,802)	100.0

FOR THE YEAR ENDED DECEMBER 31	2014		2013	
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$ 30,629**	**86.3**	$ 64,110	93.4
Comtek Advanced Structures Ltd.	**4,853**	**13.7**	4,525	6.6
Total	**35,482**	**100.0**	68,635	100.0

29. Subsequent Events

a) On March 26, 2015, Panta Canada B.V. provided Avcorp with a commitment letter specifying indicative terms of financing for a period ending March 26, 2016. Panta Canada B.V. is 100% owned by Panta Holdings B.V., and is Avcorp's majority shareholder, owning approximately 66.1% of the Company's issued and outstanding common shares as at December 31, 2014. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

The terms upon which the Company can secure up to $5,000,000 funding from Panta Canada B.V. are as follows:

Term Loan

Panta Canada B.V. has made the commitment to Avcorp to fund the Company by way of a term loan. The Company's acceptance of this commitment is subject to a 3% commitment fee payable by the Company to Panta Canada B.V. Additionally, the term loan commitment requires the issuance of common share purchase warrants, to the maximum extent allowable, without requiring Company shareholder approval; at the market price of the Company's common shares.

The terms under which the Term Loan will be provided are as follows:

- Amount not to exceed $5,000,000;
- Twelve month term from date of execution of commitment letter;
- Early repayment is required, without penalty, from proceeds of any equity injection into the Company;
- Interest rate of 8% per year; and
- Security for the term loan will be subordinated to existing security requirements.

Non-repayment at maturity date will result in the following additional conditions:

- Interest rate will increase to 15% per year; and
- Avcorp will issue to Panta Canada B.V. common share purchase warrants, to the maximum extent allowable, without requiring Company shareholder approval at the market price for the Company's common shares.

Equity Financing

Panta Canada B.V. has made the commitment to Avcorp to underwrite a $5,000,000 equity financing to occur within twelve months following date of execution of commitment letter. The underwriting is subject to the following terms:

- 3% fee based on gross proceeds of the equity placement; and
- Maximum permissible common share price discount pursuant to TSX regulations.

b) On March 26, 2015, the Company's bank extended its banking agreement from September 27, 2015 to March 31, 2016. As a condition to this extension in term, the bank requires that a capital injection amounting to $5,000,000 be made by September 27, 2015. If the Company does not receive this capital injection on or before September 26, 2015, then the banking agreement will expire on September 26, 2015.

AVCORP INDUSTRIES INC.

BOARD OF DIRECTORS AND OFFICERS

David Levi (1)(2)(3)
CHAIRMAN OF THE BOARD
Executive Chairman
GrowthWorks Capital Ltd.
Vancouver, British Columbia

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

Kees de Koning (3)
DIRECTOR
Nootdorp, The Netherlands

Elizabeth Otis (3)
DIRECTOR
Palm Springs, California

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

Ray Castelli (1)
DIRECTOR
Chief Executive Officer
Weatherhaven
West Vancouver, British Columbia

Peter George
DIRECTOR
Chief Executive Officer, Avcorp Group
Lake Tapps, Washington

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

MANAGEMENT

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

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

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

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

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

* Designates the Committee Chair

DIRECTORY

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

Ernst & Young LLP
Chartered Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Registrar and Transfer Agent

CST Trust Company
Vancouver, British Columbia

Bank

Royal Bank of Canada
Richmond, British Columbia

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