AVCORP
BETTER SOLUTIONS

Annual Report
2017

www.avcorp.com

ABOUT AVCORP INDUSTRIES INC. The Avcorp Group designs and builds major airframe structures for some of the world's leading aircraft companies, including BAE Systems, Boeing, Bombardier, Lockheed Martin and Subaru Corporation. The Avcorp Group has more than 60 years of experience, over 700 skilled employees and 636,000 square feet of facilities. Avcorp Structures & Integration located in Delta British Columbia, Canada is dedicated to metallic and composite aerostructures assembly and integration; Avcorp Engineered Composites located in Burlington Ontario, Canada is dedicated to design and manufacture of composite aerostructures, and Avcorp Composite Fabrication located in Gardena California, USA has advanced composite aerostructures fabrication capabilities for composite aerostructures. The Avcorp Group 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. Comtek Advanced Structures Ltd., at our Burlington, Ontario, Canada location also provides aircraft operators with aircraft structural component repair services for commercial aircraft.

Avcorp Composite Fabrication Inc. is wholly owned by Avcorp US Holdings Inc. Both companies are incorporated in the State of Delaware, USA, and are wholly owned subsidiaries of Avcorp Industries Inc.

Comtek Advanced Structures Ltd., incorporated in the Province of Ontario, Canada, is a wholly owned subsidiary of Avcorp Industries Inc.

Avcorp Industries Inc. is a federally incorporated reporting company in Canada and traded on the Toronto Stock Exchange (TSX:AVP).

management discussion & analysis

This Management Discussion and Analysis has been prepared as of July 10, 2018, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2017.

Description of Business

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

The Company currently operates from two locations in Canada and one location in the United States. Located in Delta, British Columbia, Avcorp Industries Inc., named as Avcorp Structures & Integration ("ASI"), is dedicated to metallic and composite aerostructures assembly and integration. Within Comtek Advanced Structures Ltd., located in Burlington, Ontario, exists two named divisions, one ("Comtek") dedicated to aircraft structural component repair services, and the second Avcorp Engineered Composites ("AEC") dedicated to design and manufacture of composite aerostructures. Located in Gardena, California, Avcorp Composite Fabrication Inc. ("ACF") is dedicated to advanced composite aerostructures fabrication.

Avcorp Industries Inc. is a federally incorporated reporting company in Canada and traded on the Toronto Stock Exchange (TSX:AVP).

Avcorp Composite Fabrication Inc. is wholly owned by Avcorp US Holdings Inc. Both companies are incorporated in The State of Delaware and are subsidiaries of Avcorp Industries Inc.

Comtek Advanced Structures Ltd., incorporated in the Province of Ontario is a wholly owned subsidiary of Avcorp Industries Inc.

Avcorp is in compliance with industry standard quality certifications.

2017 Highlights

Key financial results include:

- On April 3, 2017, the Company collected the final amount of consideration receivable from SGL Carbon SE ("SGL") for the acquisition of the US-based composite Aerostructures division of Hitco, a subsidiary of Frankfurt-listed SGL ("Hitco"), amounting to USD$9.2 million.
- On May 26, 2017, the Company signed a loan agreement to replace the current agreement with a Canadian Chartered Bank, supported by a major customer, to access a USD$58 million operating line of credit (converted as approximately CAD$72.8 million as at December 31, 2017). The Company has utilized $61,283,000 of the operating line of credit, with $5,212,000 cash on hand, as at December 31, 2017.
- Effective July 6, 2017 the Company and Panta Canada B.V. ("Panta") amended a term loan held by Panta to provide for an extended maturity date. Panta is Avcorp's majority shareholder owning approximately 68.6% of the issued and outstanding common shares on December 31, 2017. Panta is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.
- On July 31, 2017 the Company repaid a principal amount of USD$2.5 million plus interest accrued in the amount of USD$285,000 of the Panta term loan.
- On August 3, 2017 Panta exercised 12,105,327 warrants expiring August 17, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.
- On August 25, 2017 Panta exercised 6,052,664 warrants expiring September 9, 2017 at $0.07 whose aggregate price of $424,000 was deemed to be made by way of set-off against the Panta loan obligation.
- On September 8, 2017 Panta exercised 12,105,327 warrants expiring September 23, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.
- Customer order backlog increased by $249 million during 2017 due to increases in production rates, contract renewals for various existing programs, and contract awards.
- New program start-up revenues total $5.4 million in 2017 in commencement of 2016 order backlog growth for new and legacy aircraft programs.
- Six new customer production programs launched at ASI during 2017.

Highlights Subsequent to Year-End

Since December 31, 2017 key developments include:

- Avcorp is a member of Canada's Digital Technology Supercluster ("CDTS") which was awarded funding under the Federal Government's Innovation Supercluster Initiative ("ISI").
- On March 28, 2018, signed a loan agreement to expand the current agreement with a Canadian Chartered Bank, supported by a major and material customer, to access an additional USD$10 million operating line of credit.

- In Comtek's continuing effort to reduce the operator's key metric of turnaround time for repaired components, while still providing premium quality, Comtek has embarked on deploying a forward base of operations located in the United Kingdom. Doors open in the third quarter and will initially provide much needed support for the growing Q400 fleet in Europe.
- On April 19, 2018 Avcorp's Board appointed Amandeep Kaler, formerly the General Manager of Avcorp's Delta operations, as the new CEO of Avcorp Group.

Financial Overview

Three-Year Results

The following table provides selected financial information for the three years to December 31, 2017.

THREE-YEAR RESULTS

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

FOR THE YEAR ENDED DECEMBER 31	2017	2016[2]	2015
OPERATIONS			
Revenue	**$149,444**	$183,707	$80,416
EBITDA[1]	**(48,342)**	(13,762)	(8,093)
Operating loss	**(53,773)**	(16,405)	(11,623)
Net loss[3]	**(58,538)**	(19,959)	(12,154)
Basic and diluted loss per share	**(0.18)**	(0.07)	(0.04)
FINANCIAL POSITION			
Capital expenditures	**3,054**	6,836	959
Total assets	**113,276**	133,076	160,091
Bank indebtedness and term debt	**64,453**	25,040	1,886
Shareholders' (deficit) equity	**(57,405)**	(6,883)	6,784
Net book value per share[4]	**(0.17)**	(0.02)	0.02
Ratio: current assets/current liabilities	**0.53**	0.94	1.40
Shares outstanding at period end	**337,404,502**	307,141,184	305,555,184

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS").
2. It should be noted that in 2016, the loss and EBITDA incorporated substantial costs incurred which have yet to be recovered from the seller of Hitco. No recovery of these costs has been recorded, as an estimated amount cannot be reasonably determined at this time.
3. On the acquisition of Hitco on December 18, 2015, Avcorp assumed the unfavourable contract liability and customer advance arising from specific customer contracts. In previously filed financial statements the Company recorded the foreign exchange gain on these acquired liabilities through the statement of operations. Upon further analysis in 2017, it was determined that the foreign exchange gains on these items should have been recorded through other comprehensive income in the statement of equity. As a result the Company has reclassified $3,995,000 from foreign exchange gain to other comprehensive income in the year ended December 31, 2016, as well as a reclassification of $861,000 from January 1, 2016 Deficit to Accumulated Other Comprehensive Income.
4. Net book value per share is not a recognized term under IFRS.

Avcorp's recurring contracted revenue base remains strong as customers continue to place orders within existing long-term supply agreements. 2017 production revenues have decreased by $10,302,000 from 2016, exclusive of the 2016 $33,019,000 amortization and contract renegotiation of the unfavourable contract liability into revenue (December 31, 2017: $9,058,000). Recent customer contract awards contributed $5,395,000 to 2017 revenues in comparison to $Nil for 2016.

The three primary factors underlying the year on year reduction in revenues are: 2016 revenues include amortization for the unfavourable contract liability, which amounted to $33,019,000 in 2016 (2017: $9,058,000); wind-down of certain loss-making contracts acquired in the Hitco acquisition; change in aircraft repairs cycles; and a significant transfer of defence program deliveries from 2017 into 2018.

Growth in revenues from 2015 to 2016 was primarily attributable to the December 18, 2015 Hitco acquisition.

During 2017 the Company continued with its strategic approach for securing business growth in the composite aircraft structures assembly market, to further diversify its aerostructures market position, leveraging its 2015 acquisition of Hitco. The Hitco acquisition, which required significant turn-around expenditures and was severly burdened with operational inefficiencies and extensive legacy product warranty obligations, reduced Earnings Before Interest, Taxes, Depreciation & Amortization ("EBITDA") for the Group. Although expenditures have now been reduced, the Company continues to consume significant resources for the Hitco turn-around.

The 2016 $16,405,000 operating loss contains a $38,937,000 amoritization of an unfavourable contract liability into income; without which the operating loss for 2016 was $55,342,000. On a comparative basis, the 2017 $53,773,000 operating loss contains a $9,058,000 amoritization of an unfavourable contracts liability into income; without which the operating loss was $62,831,000. Additional provisions for onerous contracts amouting to $13,603,000 during 2017 have caused operating results to deteriorate. Certain of those contracts are being wound down in 2018. The 2015 $11,623,000 operating loss contains a $356,000 amoritization of an unfavourable contracts liability into income, as this amoritization only impacted the December 18, 2015 post-acquisition period to December 31, 2015.

Capital expenditures during the three year period presented have been limited to upgrading manufacturing equipment and capabilities, in particular for new program introductions, as well as information technology assets; with $1,892,000 of capital expenditures incurred at Avcorp's Gardena facility in order to rectify equipment deficiencies and improve the effectiveness of operational capabilities.

Bank indebtedness and term debt increased by $40,739,000 in 2017 over 2016. Cash flows from operating activities, before consideration of changes in non-cash working capital, decreased by $42,257,000 during the year ended December 31, 2017 as compared to a $59,091,000 decrease of cash during the year ended December 31, 2016. Cash flows from operating activities were most significantly impacted as a result of operating losses incurred from the integration and production costs expended for the acquired Hitco operations; losses arising from unfavourable customer contracts assumed; and operational, administrative, and legal expenditures, incurred at Avcorp's Gardena facility; as well as new program introduction and start-up costs at the Delta facility. 2015 bank debt and 2016 bank debt were reduced by $32,826,000 and $22,429,000 respectively as a result of cash consideration received from the December 18, 2015 Hitco acquisition (December 31, 2017: $12,378,000).

Quarterly Results

The following table provides selected unaudited quarterly consolidated financial information for the eight most recent fiscal quarters to December 31, 2017 prepared in accordance with IAS 34 – Interim Financial Reporting ("IAS 34") as issued by the International Accounting Standards Board ("IASB").

QUARTERLY RESULTS

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

	2017				2016[2]			
FOR THE THREE MONTHS ENDED	Dec 31	Sep 30[3]	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	**$37,923**	$36,267	$36,686	$38,568	$46,183	$47,349	$50,234	$39,941
Operating (loss) income	**(27,342)**	(6,644)	(11,170)	(8,617)	9,233	(12,060)	(6,010)	(7,568)
EBITDA[1, 4]	**(24,493)**	(6,253)	(10,003)	(7,593)	12,496	(8,413)	(5,412)	(12,433)
Net (loss) income[4]	**(27,469)**	(8,444)	(12,512)	(10,113)	10,578	(9,963)	(6,738)	(13,836)
EBITDA per share[1]								
Basic	**(0.07)**	(0.02)	(0.03)	(0.02)	0.04	(0.03)	(0.02)	(0.04)
Diluted	**(0.07)**	(0.02)	(0.03)	(0.02)	0.04	(0.03)	(0.02)	(0.04)
Net (loss) income per share								
Basic	**(0.08)**	(0.03)	(0.04)	(0.03)	0.03	(0.03)	(0.02)	(0.05)
Diluted	**(0.08)**	(0.03)	(0.04)	(0.03)	0.03	(0.03)	(0.02)	(0.05)
Long-term debt	**2,973**	1,919	1,588	1,617	1,646	1,674	1,650	1,649

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS"), refer to page 10.
2. It should be noted that in 2016, the loss and EBITDA incorporated substantial costs incurred which have yet to be recovered from the seller of Hitco. No recovery of these costs has been recorded, as an estimated amount cannot be reasonably determined at this time.
3. Restatement: Effective July 1, 2017, the Company changed its functional currency from Canadian dollars ("CAD") to United States ("US") dollars ("USD") for Avcorp Industries Inc. and Comtek Advanced Structures Limited. The Company applied the change in functional currency on a prospective basis. After further subsequent evaluation of the entities' revenue and cost cash flows as well as the Company's financing agreements, the Company has determined that the functional currency of these two entities should not have been changed. Consequently, the Q3 2017 financial results above have been restated to reflect the functional currency of Avcorp Industries Inc. and Comtek Advanced Structures Limited as the CAD. The impact of this restatement was to increase Q3 2017 net income by 1,219,000, and increase assets by 1,454,000.
4. On the acquisition of Hitco on December 18, 2015, Avcorp assumed the unfavourable contract liability and customer advance arising from specific customer contracts. In previously filed financial statements the Company recorded the foreign exchange gain on these acquired liabilities through the statement of operations. Upon further analysis in 2017, it was determined that the foreign exchange gains on these items should have been recorded through other comprehensive income in the statement of equity. As a result the Company has reclassified $3,995,000 from foreign exchange gain to other comprehensive income in the year ended December 31, 2016, as well as a reclassification of $861,000 from January 1, 2016 Deficit to Accumulated Other Comprehensive Income.

During 2017 certain production contracts for commercial aircraft were wound down at Avcorp Composite Fabrication Inc., as planned during the Hitco acquisition; however, additional operating inefficiencies contributed to quarterly operational losses. The Company continues to focus on reducing the cost structure in Gardena by consolidating facility usage and staffing levels via lean production techniques.

2016 income benefited from $38,937,000 of amortization into income of an unfavourable contracts liability (2017: $9,058,000); however, additional provisions for onerous contracts amounting to $13,603,000 during 2017 have caused operating results to deteriorate. Such contracts are being wound down in 2018.

2017 and 2016 Results Overview

During the year ended December 31, 2017 Avcorp Group revenues totalled $149,444,000 compared with $183,707,000 for the previous year.

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.

2017 revenues arising from the assignment by customers of commercial aerospace contracts to Avcorp Industries Inc. in conjunction with the December 18, 2015 Hitco acquisition have generated $50,946,000 in revenue (December 31, 2016: $67,492,000). These contracts support customer production of commercial aircraft. Manufacturing of the composite parts occurs in Avcorp Group's **Gardena facility**. The Gardena facility was assigned defence aerospace contracts by Hitco's customers upon the finalization of the acquisition. These contracts generated $19,879,000 of revenue during the year ended December 31, 2017 for ACF (December 31, 2016: $17,369,000). Issues with deliveries of products and services within the Gardena production supply chain impacted this facility's ability to have delivered to available customer demand; planned wind-down of certain commercial contracts assigned from the Hitco acquisition further reduced revenues. However, the March 31, 2017 and subsequent May 26, 2017 increases to the Company's existing credit facility with a Canadian chartered bank cumulatively to USD$58,000,000 alleviated supply chain constraints during the year. The majority of the loss making production contracts for the Gardena facility, which were assumed with the Hitco acquisition, have been re-priced or will be wound-down by the end of 2018.

The **Burlington facility** had an increase in the delivery of composite floor panels in supply to Bombardier Aerospace's Global 5000/6000 and Global 7000/8000 programs during the current year, with a 71% increase in production for these contracts in 2017 versus 2016 (a $1,850,000 revenue increase 2017 over 2016). Full rate production for these programs establishes the wholly owned subsidiary as a leading manufacturer of composite floor panels. Composite floor panel revenues arising from aftermarket, spare, or other original equipment manufacturers ("OEM") composite floor panel sales were reduced during 2017 relative to 2016; a 16% decrease ($1,210,000 revenue reduction in 2017 relative to 2016) This facility has had significant success during 2017 in growing its sales base for other composite component deliveries to OEMs. Sales in this market segment grew by 86% in 2017 relative to 2016 ($1,724,000 revenue increase). Composite aircraft repair revenues out of Comtek were $3,779,000 lower in 2017 in comparison to 2016, as regional airline customers implemented cost reduction initiatives and fleet aircraft mix changes; while it is anticipated that new market penetration and a backup of regional airline repairs will augment the 2018 revenue base. Burlington cost structure related to overhead, administration and general expenses were reduced in 2017 relative to 2016 in efforts to reduce the impact of the current revenue reduction while providing a cost effective organizational structure basis for 2018 revenue growth.

Delta facility revenues, for all programs generated by production contracts, have increased by $5,149,000 during the current year relative to the previous year (an 11% increase for 2017 in comparison to 2016). On a delineated basis, Delta revenues from the production and delivery for business jet programs has increased by approximately $2,698,000 as customer demand for the products has increased in 2017 over 2016; commercial aircraft production supply increased by $2,170,000 in 2017 as compared to 2016 primarily due to the 2017 start-up of production for a higher complexity assembled structure, offsetting decreases in legacy programs; defence programs' production has increased only slightly as customer delivery requirements have been shifted from the first half of 2017 into 2018.

Avcorp's Delta location continues to actively pursue production contracts on aerospace programs throughout North America, Asia, and Europe both in the commercial and defence aerospace sectors. These production contracts consist of complex metal bond and multi-material structural assemblies that complement Avcorp's capability as a strategic integrated supplier within the aerospace industry. Production and deliveries for recent contract awards commenced during the current year for the Delta facility providing $5,395,000 revenues in 2017. Delta operating losses in 2017 were primarily as a result of a single fixed quantity new commercial aircraft program introduction. Significant efforts have been made in 2017 to improve operational efficiencies, including automation, which reduce this programs losses in 2018.

For the year ending December 31, 2017, the **Avcorp Group** recorded losses from operations totaling $53,773,000 from $149,444,000 revenue, which include costs incurred on start-up of new programs, as compared to $16,405,000 operating losses from $183,707,000 revenue for the previous year. Program introduction and start-up costs for new programs, deferred defense production deliveries, continued production and delivery of onerous contracts, for which the Company provided an additional $13,603,000 in onerous contracts provision in 2017, as well as a shift in customer requirements for aircraft repairs have caused operating losses in 2017. Furthermore, issues with deliveries of products and services within the production supply chain were a major cause for sales not to have filled available customer demand, causing a revenue shortfall; as well as an adverse financial impact resulting from inconsistent supply chain deliveries which caused inefficient production 'work-arounds' within the facility. It should be noted that 2016 operating losses benefited by $38,937,000 income from amortization of an unfavourable contract liability into income (2017: $9,058,000).

An unfavourable contract liability accruing for certain customer contracts, for which unavoidable costs are expected to exceed the corresponding revenue earned, amounted to $100,582,000 upon the December 18, 2015 Hitco acquisition; of which $44,460,000 remains unamortized as at December 31, 2017 (December 31, 2016: $56,969,000). The unfavourable contract liability is amortized into income on a units-of-production basis over the expected life of the contract and as costs are incurred. The amount of unfavourable contract liability amortized into income during the year ended December 31, 2017 was $9,058,000 (December 31, 2016: $38,937,000). The unamortized unfavourable contract liability is accrued in US dollars and therefore the unamortized balance will vary from quarter to quarter as the estimated provision is adjusted for foreign currency fluctuations.

Over the course of 2016 and through 2017, certain of the smaller loss making contracts at the Gardena facility are being wound down eliminating the associated losses. The remaining significant loss making contract has been the focus of a comprehensive Company initiative under which management is working with a customer to facilitate an orderly transition of this significant loss making contract away from Avcorp's Gardena facility.

Although recent customer contract awards will continue to increase facility utilization, there remains significant levels of unutilized plant capacity within the Company's Delta, British Columbia facility. The Company has expensed $4,309,000 of overhead costs during the year as compared to $4,408,000 for December 31, 2016 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. Although, revenue growth in this facility would benefit Company profitability via a contribution to the recovery of fixed overhead expenditures, new program introduction expenditures and learning curve costs related to new program start-ups at Delta have added $2,029,000 to current year operating losses. Avcorp is engaged with aerospace OEM's as well as industry tier 1 suppliers in North America, Asia and Europe in collaborative production initiatives that support the Company's recent transition to composite manufacturing capabilities, further leveraging existing production capacity and investments.

During the year ended December 31, 2017, cash flows from operating activities, excluding the impact of changes in non-cash working capital, utilized $42,257,000 of cash as compared with utilization of $59,091,000 of cash during the year ended December 31, 2016. Cash flows from operating activities were most significantly impacted as a result of operating losses incurred from the integration and production costs expended for the acquired Hitco operations; losses arising from unfavourable customer contracts assumed; operational, administrative, and legal expenditures incurred in support of Avcorp's Gardena facility; as well as new program introduction and start-up costs at the Delta facility.

Changes in non-cash working capital during the current year utilized cash flows from operating activities in the amount of $347,000 as compared to the previous year during which non-cash working capital provided $8,744,000; accounts receivable provided cash and accounts payable used cash in 2017 compared to 2016 during which accounts receivable and payable provided cash.

Pursuant to the Hitco acquisition, the Company assumed a customer advance for pre-funding of product deliveries. The customer advance is re-paid as the Company delivers to its customer ordered products for a specific program. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company's bank and the customer. The remaining unamortized customer advance has been discounted to arrive at the December 31, 2017 amount of $7,227,000 (December 31, 2016: $11,573,000) of which it is estimated $7,227,000 will be amortized during the next twelve months. The Company re-paid and amortized into income $4,346,000 of the customer advance during the year ended December 31, 2017 (December 31, 2016: $6,955,000).

As at December 31, 2017, the Company had $5,212,000 cash on hand (December 31, 2016: $3,960,000) and had utilized $61,283,000 of its operating line of credit (December 31, 2016: $17,111,000). The Company has a working capital deficit of $63,613,000 as at December 31, 2017 which has increased from the December 31, 2016 $5,439,000 deficit. Working capital surplus/deficit is defined as the difference between current assets and current liabilities. The increase in bank utilization during 2017 has increased the working capital deficit in 2017 over 2016. However, the Company's accounts receivable and inventories net of accounts payable, amount to a $37,889,000 surplus as at December 31, 2017 (December 31, 2016: $38,436,000 surplus). The Company's accumulated deficit as at December 31, 2017 is $157,185,000 (December 31, 2016: $98,647,000).

ACF Gardena

The ACF commercial operations in Gardena faced several significant unanticipated challenges during 2016, immediately post-acquisition which continued to have an adverse financial impact into 2017 as the Company's operational turn around initiatives were significantly delayed. Operational losses, incurred at the Gardena facility amounted to $33,035,000 for the year ended December 31, 2017 as compared to $4,078,000 operating losses for 2016. Gardena 2016 operating losses benefited by $38,937,000 income from amortization of an unfavourable contract liability into income (2017: $9,058,000). Product quality and warranty claims on product delivered by Hitco pre-acquisition, although indemnified under the asset purchase agreement with Hitco and SGL, further adversely impacted operations and caused excessive personnel costs, and administrative and legal expenditures at ACF's Gardena facility during the periods. These costs have yet to be recovered and are included in all the costs for 2016 and into 2017.

As a result of legacy quality issues raised by customers on Hitco products delivered prior to the acquisition, a substantial and large number of items were identified that required corrective action. These items accounted for substantial expenditures, including extra contract personnel beyond normal production levels, for which losses ACF has yet to be indemnified by Hitco or SGL.

The complexity and challenge of executing the production start-up and improvement plans for the Gardena operations increased from pre-acquisition estimates. Avcorp continues to work successfully with its commercial and defence aerospace customers to update plans and commitments to ensure support for their programs and maintain purchase order schedules.

Over the course of 2016 and through 2017 certain of the smaller loss making contracts at the Gardena facility were being wound down eliminating the associated losses; and the period of performance for the most significant loss making contract was reduced by four years. What will be the remaining significant loss making contract continues to be the focus of a comprehensive Company initiative under which management is working with a major customer for an orderly and protected transition of this significant loss making contract from Avcorp's Gardena facility. Contract revisions are in place which are expected to improve Avcorp's financial performance.

Revenue

For the year ended December 31, 2017 revenues totalled $149,444,000, a $34,263,000 reduction in revenues relative to 2016 (December 31, 2016; $183,707,000).

The four primary factors underlying the year on year reduction in revenues are: 2016 revenues include amortization into revenue for the unfavourable contract liability which amounted to $33,019,000 in 2016 (2017: $9,058,000); wind-down of certain loss-making contracts acquired in the Hitco acquisition; change in aircraft repairs cycles; and a significant transfer of defence program deliveries from 2017 into 2018.

New program start-up revenues contributed $5,395,000 to 2017 revenue in commencement of the $523 million increase in order backlog which occurred in 2016 for new and legacy aircraft programs.

Operating segment revenues are as follows:

REVENUE DISTRIBUTION

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

FOR THE YEAR ENDED DECEMBER 31	2017		2016	
	Revenue	% of Total	Revenue	% of Total
Avcorp Industries Inc. (ASI)	**$51,485**	**34.4**	$46,483	25.3
Comtek Advanced Structures Ltd. (AEC)	**18,076**	**12.1**	19,491	10.6
Avcorp Composite Fabrication Inc.[1] (ACF)	**79,883**	**53.5**	117,733	64.1
Total	**149,444**	**100.0**	183,707	100.0

1. ACF revenue includes amortization of a portion of the unfavourable contract liability of $9,058,000 in 2017 (December 31, 2016: $33,019,000).

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.

Delta facility new commercial aircraft program revenues have contributed $5,395,000 of revenue growth in 2017 over 2016. Revenue from the production and delivery for business jet programs has increased by approximately $2,698,000 as customer demand for the products has increased in 2017 over 2016. Production for defence programs remained flat in 2017 relative to 2016; however, customer delivery requirements for these products has increased but moved into 2018.

Avcorp's Delta location continues to actively pursue production contracts on aerospace programs throughout North America, Asia, and Europe both in the commercial and defence aerospace sectors. These production contracts consist of complex metal bond and multi-material structural assemblies that complement Avcorp's capability as a strategic integrated supplier within the aerospace industry. Production and deliveries for recent contract awards commenced during 2017 for the Delta facility.

The **Burlington facility** had an increase in the delivery of composite floor panels in supply to Bombardier Aerospace's Global 5000/6000 and Global 7000/8000 programs during the current year, with a 71% increase in production for these contracts in 2017 versus 2016 (a $1,850,000 revenue increase 2017 over 2016). Full rate production for these programs establishes the wholly owned subsidiary as a leading manufacturer of composite floor panels. Composite floor panel revenues arising from aftermarket, spare, or other original equipment manufacturers ("OEM") composite floor panel sales were reduced during 2017 relative to 2016; a 16% decrease ($1,210,000 revenue reduction in 2017 relative to 2016) This facility has had significant success during 2017 in growing its sales base for other composite component deliveries to OEMs. Sales in this market segment grew by 86% in 2017 relative to 2016 ($1,724,000 revenue increase). Composite aircraft repair revenues out of Comtek were $3,779,000 lower in 2017 in comparison to 2016, as regional airline customers implemented cost reduction initiatives and fleet aircraft mix changes; while it is anticipated that new market penetration and a backup of regional airline repairs will augment the 2018 revenue base.

Effective December 18, 2015, Avcorp completed the acquisition of the US-based composite Aerostructures division of Hitco, a subsidiary of Frankfurt-listed SGL. The Acquisition was completed pursuant to the terms of an asset purchase agreement that was entered into on July 20, 2015, and subsequent amendments to December 18, 2015. Pursuant to the Agreement Avcorp's subsidiary, Avcorp Composite Fabrication Inc., (the Group's **Gardena facility**) purchased the assets of the division of Hitco which produces composite structural parts for commercial and military aerostructures.

Despite the challenges encountered, the acquisition of Hitco's Aerostructures composite division has provided Avcorp the unique opportunity to transform the Avcorp Group's existing metal fabrication and integrated assembly business by broadening the product range and strengthening Avcorp's composite capabilities. Advanced composite fabrication capabilities, provided by this acquisition, will enhance Avcorp Group's ability to participate in large aerospace assembly programs which combine mixed material components.

2017 revenues arising from the assignment by customers of commercial aerospace contracts to Avcorp Industries Inc. in conjunction with the December 18, 2015 Hitco acquisition have generated $50,946,000 in revenue (December 31, 2016: $67,345,000). These contracts support customer production of commercial aircraft. Manufacturing of the composite parts occurs in Avcorp Group's Gardena facility. The Gardena facility was assigned defence aerospace contracts by Hitco's customers upon the finalization of the acquisition. These contracts generated $19,879,000 of revenue during the year ended December 31, 2017 for ACF (December 31, 2016: $17,369,000). Issues with deliveries of products and services within the Gardena production supply chain were the primary cause for this facility not to have delivered to available customer demand. The May 26, 2017 increase of the Company's existing credit facility with a Canadian chartered bank to USD$58,000,000 alleviated supply chain constraints during the second half of 2017 and provided the necessary liquidity to commence normal operating conditions.

Deliveries and quality performance as at December 31, 2017 for Canadian manufacturing operations were at customer required levels. The manufacturing operations have achieved, and continue to maintain, top quality and delivery ratings for the majority of their programs.

In conjunction with the Hitco acquisition, Hitco and its ultimate parent SGL Carbon SE have the contractual responsibility and liability for certain losses incurred by Avcorp in connection with quality and warranty claims pertaining to finished goods delivered by Hitco before the closing date and certain finished goods manufactured by Hitco before the closing date that were designated as conforming inventory. Immediately after the Hitco acquisition, a thorough quality and delivery review and audit was conducted of Hitco's Gardena manufacturing operations by ACF, which has produced improvement plans together with its customers. ACF continues to work collaboratively with customers to ensure any quality and delivery issues are fully resolved at the earliest date.

Revenues from Avcorp Group customers are as follows:

REVENUE DISTRIBUTION

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

FOR THE YEAR ENDED DECEMBER 31	**2017**		2016	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$5,413**	**3.6**	$5,352	2.9
Boeing[1]	**59,089**	**39.5**	80,735	43.9
Bombardier	**19,134**	**12.8**	16,047	8.7
Lockheed Martin	**15,735**	**10.5**	12,659	6.9
Subaru Corporation (formerly Fuji Heavy Industries)	**24,566**	**16.4**	15,789	8.6
Other	**16,449**	**11.0**	20,106	11.0
Amortization and contract renegotiation of the unfavourable contract liability	**9,058**	**6.2**	33,019	18.0
Total	**149,444**	**100.0**	183,707	100.0

1. Includes Boeing program partner revenue

The Avcorp Delta BC facility is the single source supplier for the F-35 CV-OBW assembly under contract with **BAE Systems ("BAES")**, 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 more complex assemblies that the Canadian aerospace industry contributes to the F-35 program. Production demand for the F-35 CV-OBW has increased in 2017 relative to 2016, with more significant increase in deliveries to occur in 2018. Production contracts have been secured through to end of 2019, with discussions underway with the customer to secure constant production through to mid-2022. The Company announced that further to the contract award from Lockheed Martin announced on October 15, 2015 for the expanded scope on the F-35 CV-OBW, Avcorp has received a firm order for the remaining units in the next two production phases, referred to as Low Rate Initial Production ("LRIP") Nine and LRIP Ten. Avcorp's established New Product Introduction ("NPI") process will ensure the successful knowledge and skills transfer from Lockheed Martin, required for the intricate work of paint preparation and complex installation of control surfaces and systems such as the outboard leading edge flaps, ailerons, fairings and sub-systems. The delivery of the first shipset to Lockheed Martin's Final Assembly and Check Out facility in Fort Worth, Texas, USA was in August 2016, with subsequent confirmed orders extending out to 2019, and discussions underway with the customer to secure constant production through to mid-2022.

Avcorp's Gardena California facility provides substantial content for all three models of the F-35 fighter aircraft. Fabricated components include: wing skins, upper and lower, nacelles, access panels, and a strap component that serves as a structural backbone to the aircraft. Avcorp fabricates these complex structures through a combination of both automated robotic fiber placement and hand laid graphic fabric methods. Avcorp is under a multi-year contract with Lockheed Martin Corporation, who release order quantity and schedule requirements that coincide with their fiscal year. The current period of performance extends through 2019. Follow on contract value is anticipated, assuming acceptable quality and delivery performance. Revenues for this long-term defence program totalled $15,735,000 for the year ended December 31, 2017 (December 31, 2016: $12,659,000).

Shipments of large metallic assemblies to **Boeing Commercial Airplane Group ("Boeing")**, primarily for the 737 commercial jet program, increased by 33% during 2017 relative to 2016, primarily as a result of a newly awarded program start-up. Concurrently, deliveries of fabricated parts and components to Boeing decreased 5% as customer demand for discrete and lower complexity assembled structures has been reduced. However, commencement of production in 2017 for certain 2016 awarded parts and components will achieve full rates of production in 2018. During 2016, Avcorp delivered its first significant quantity of shipsets of composite fabricated aerostructures parts for Boeing programs from its acquired Gardena production facility. 2017 revenues for these composite parts totalled $21,625,000 (December 31, 2016: $39,780,000), a reduction from 2016 as the planned wind-down of certain Hitco acquired customer contracts takes place. Total revenues generated for the Company from various Boeing Commercial aircraft programs amounted to $51,058,000 (December 31, 2016: $64,869,000). The Company also delivers components to **Boeing Defense, Space & Security ("Boeing DSS")** for the Chinook CH47 helicopter. During the year ended December 31, 2017 the Company generated $3,697,000 of revenues in supply to Boeing DSS, a decrease in revenues recorded for the same period in 2016 (December 31, 2016: $4,261,000) reflecting variances in timing of customer demand. The Avcorp Delta BC facility announced on October 26, 2015 that it has been awarded the production contract for the supply of Boeing 767-2C Panoramic Camera Fairings. Furthermore, the Delta facility was able to secure the production contract for the Boeing 767 Flap Track Fairings. Both new programs were in the production set-up phase during 2016 and have commenced to generate revenues in 2017. 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 increased during the current year relative to the year ended December 31, 2016. Shipments of large assemblies for the CL605 business jet program increased by $2,698,000 during the current year as demand for these products has increased relative to 2016; while the Company experienced a $1,850,000 increase in its deliveries of composite floor panels to Bombardier primarily as a result in the growth of Global 5000/6000 and Global 7000/8000 program deliveries. Avcorp Group's primary source of revenues from Bombardier in 2017 will continue to be from components for the CL605 and CL850 business jets, composite floor panels for the CRJ and Q400 aircraft programs, as well as a sustained rate of production of composite floor panels for Bombardier's Global 5000/6000 and Global 7000/8000 programs.

Avcorp's deliveries to **Subaru Corporation ("Subaru")** of large complex composite structural components which are integrated into the centre wing box in support of the Boeing 787 commercial jet program totalled $24,566,000 for the current year (December 31, 2016: $15,789,000). This is a significant commercial production contract being manufactured in the Gardena facility. This long term agreement represents an important relationship with a long-standing industry tier one supplier.

Composite aircraft structure repair revenues out of Comtek were reduced as regional airline customers implement cost reduction initiatives and fleet aircraft mix changes, causing 2017 revenues to decrease by $3,779,000 relative to revenues in the previous year. The Group also supplies Canadian aircraft retro-fit programs out of its Delta facility, and large composite structures in support of various US defense programs out of its Gardena facility. These revenues were reduced relative to 2016 as certain of these programs were wound down. These **Other** revenues are of significant importance to the Group's operations as they generated $16,449,000 in revenue during the year ended December 31, 2017 (December 31, 2016: $20,106,000).

Defence program revenues for Avcorp during 2017 totalled $29,772,000 (December 31, 2016: $26,982,000); 21% of total revenues (December 31, 2016: 18%). **Commercial program revenues** continue to provide the majority of the Company's revenue (December 31, 2017: 79%; December 31, 2016: 82%) amounting to $110,613,000 for 2017 and $123,707,000 for 2016. The Group continues to move forward with its revenue diversification between commercial and defence aerospace programs. Included in total revenues for the Company is the amortization and contract renegotiation of the unfavourable contract liability of $9,058,000 in 2017 (2016: $33,019,000).

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2017 was negative 21.3% of revenue compared to positive 4.6% of revenue for the year ended December 31, 2016. Included in the calculation of gross profit is the amortization of the unfavourable contract liability of $9,058,000 into revenue and cost of sales in 2017 (2016: $36,936,000). Exclusive of the unfavourable contract liability amortization into revenue and cost of sales, the negative gross profit for 2017 would be $40,910,000 (December 31, 2016: $28,562,000 negative gross margin). Additional provisions for onerous contracts amounting to $13,603,000 during 2017 have caused operating results to deteriorate.

The start-up, post-acquisition of the operations in Gardena, faced several unanticipated challenges during the first half of 2016. As a result of legacy quality issues raised by customers, a number of items were identified that required corrective action. These items accounted for substantial expenditures beyond normal production costs. Staffing levels during the third and fourth quarters 2016 for the Gardena facility continued to remain very high relative to production deliveries as the operations utilized production resources to implement customer supported corrective actions. Consequently, key turn around initiatives were delayed into 2017 significantly delaying gross margin improvements on production contracts manufactured out of the Gardena facility. The Gardena facility gross margin for the current year was negative $27,588,000 (December 31, 2016: $4,440,000 positive gross margin). 2017 Gardena facility gross margin, exclusive of the $9,058,000 amortization of the unfavourable contract liability into revenue is negative $36,646,000. On a comparative basis exclusive of the 2016 $36,936,000 amortization of the unfavourable contract liability into revenue and cost of sales, the 2016 Gardena facility gross margin was negative $32,496,000.

Many corrective actions have been implemented. As legacy operational deficiencies are rectified, additional operational improvements were made in the second half of 2016 and into 2017, thereby allowing the Gardena operations to achieve fully contracted output levels, however at a continuing high cost structure during the first half of 2017. Avcorp's key commercial customers have worked collaboratively with Avcorp to mitigate production schedule risks and support the earliest resolution of the outstanding process and product issues. Furthermore, certain of the smaller loss making contracts at the Gardena facility are being wound down eliminating the associated losses. The remaining significant loss making contract has been the focus of a comprehensive Company initiative under which management is working with a customer to facilitate an orderly transition of this significant loss making contract away from Avcorp's Gardena facility.

Delta and Burlington production contracts produced a combined negative gross margin for the year ended December 31, 2017 of $4,264,000 as compared with a gross margin of $3,934,000 for 2016; primarily caused by a shifting into 2018 customer demand for defence aircraft, as well as start-up costs incurred with Delta's new programs' introduction into production. Furthermore, the recent shift in regional airline repairs schemes have caused Burlington gross margins to decrease in this market segment.

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $4,309,000 of overhead costs during the year (December 31, 2016: $4,408,000) in respect of unutilized plant capacity.

Administration and General Expenses

As a percentage of revenue, administration and general expenses increased slightly to 14.4% for the year ended December 31, 2017 from 13.3% for the year ended December 31, 2016. In absolute terms, administration and general costs decreased by $2,849,000 during the current year relative to the prior year. Legal and professional services incurred during the prior year were substantial and continue as the Company administers various contracts and agreements assigned from and ancillary to its asset purchase agreement with Hitco and Frankfurt-listed SGL, which became effective on December 18, 2015.

Foreign Exchange Gain or Loss

Avcorp Group recorded a $1,944,000 foreign exchange gain during the year ended December 31, 2017 (December 31, 2016: $3,278,000 gain) as a result of holding US dollar-denominated cash, receivables, payables and debt.

Earnings Before Interest, Taxes, Depreciation & Amortization

Avcorp Group 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.

EBITDA was negative $48,342,000 for the year ended December 31, 2017 compared to EBITDA of negative $13,762,000 for the year ended December 31, 2016. Included in the calculation of EBITDA is the amortization of the unfavourable contract liability of $9,058,000 into income in 2017 (December 31, 2016: $38,937,000). Additional provisions for onerous contracts amounting to $13,603,000 during 2017 have caused operating results to deteriorate. Such contracts are being wound down in 2018; or completed in 2019.

Significant pre-existing operational deficiencies and excessive cost structure within the acquired Hitco operations resulted in poor production contract performance and adversely affected Group earnings for 2016 and have continued through into 2017 as turnaround initiatives for the Gardena facility were significantly deferred. As legacy operational deficiencies were identified, operational improvements were made, thereby allowing the Gardena operations to achieve fully contracted output levels. Avcorp's key commercial customers have worked collaboratively with Avcorp to mitigate production schedule risks and support the earliest resolution of the outstanding process and product issues.

Delta and Burlington EBITDA was adversely affected for the current year primarily due to a shifting into customer demand for defence aircraft, as well as start-up costs incurred with Delta's new programs' introduction into production. Furthermore, the recent shift in regional airline repairs schemes have caused Burlington earnings to decrease in this market segment; while it is anticipated that new market penetration and a backup of regional airline repairs will augment the 2018 revenue base.

The financial results presented for the year ended December 31, 2017 do not take into account any recovery provision for the operational expenditures for which the Company believes it is indemnified for under its asset purchase agreement with Hitco and SGL. These expenditure recovery amounts are not finalized and cannot be practicably quantified at this time and there is uncertainty as to the amount that will be recovered.

The start-up, post-acquisition, of the new operations in Gardena faced several unanticipated challenges during the first quarter 2016. As a result of legacy quality issues raised by customers, a number of items were identified that required corrective action. These items accounted for substantial expenditures beyond normal production costs.

The complexity and challenge of executing the production start-up and improvement plans for the Gardena operations increased from the pre-acquisition estimates.

Over the course of 2016 and 2017 certain of the smaller loss making contracts produced out of the Gardena facility were being wound down eliminating the associated losses. What will be the remaining significant loss making contract has been the focus of a comprehensive Company initiative under which management has commenced planning with a major customer for an orderly and protected transition of this significant loss making contract from Avcorp's Gardena facility. Contract revisions are completed for the significant loss making contract, which have significantly reduced the required period of delivery.

EBITDA[1]

(expressed in thousands of Canadian dollars)

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016	2015
Income loss for the year	**$(58,538)**	$(19,959)	$(12,154)
Interest expense and financing charges	**2,820**	353	860
Income tax expense	**-**	-	-
Depreciation	**4,153**	3,915	1,680
Amortization of development costs and intangibles	**3,223**	1,929	1,521
	(48,342)	(13,762)	(8,093)

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, 2017 were $2,806,000, which is net of $14,000 interest income as compared with to $339,000 expense, net of $14,000 interest income for the year ended December 31, 2016. Interest expenditures have increased during the current year relative the previous year as bank indebtedness has increased substantially.

Income Taxes

Avcorp Group has not incurred a tax expense during the year ended December 31, 2017 (December 31, 2016: $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, 2017 was $58,538,000 compared to a loss of $19,959,000 for the year ended December 31, 2016. Significant pre-existing operational deficiencies and excessive cost structure within the acquired Hitco operations have resulted in poor production contract performance and significantly adversely affected Group earnings, Operational turn around initiatives, although delayed, have commenced. Income was also adversely affected during the current year due to a shifting into 2018 of customer demand for defence aircraft, as well as start-up costs incurred with Delta's new programs' introduction into production. Furthermore, the shift in regional airline repairs schemes have caused Burlington earnings to decrease in this market segment; while it is anticipated that new market penetration and a backup of regional airline repairs will augment the 2018 revenue base. The 2016 $16,405,000 operating loss contains a $38,937,000 amoritization of an unfavourable contract liability into income; without which the operating loss for 2016 was $55,342,000. On a comparative basis, the 2017 $53,773,000 operating loss contains a $9,058,000 amoritization of an unfavourable contracts liability into income; without which the operating loss was $62,831,000. Additional provisions for onerous contracts amounting to $13,603,000 during 2017 have caused operating results to deteriorate. Such contracts are being wound down in 2018; or completed in 2019.

Liquidity and Capital Resources

On May 26, 2017, the Company entered into a loan agreement to expand its operating credit facility with a Canadian Chartered bank. This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012. This loan amendment provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at March 31, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The loan matures on June 30, 2020.

Interest rate for advances made up to the maximum of the allowable borrowing base on the existing USD$23,000,000 revolving loan:

- RBP plus 0.75% per annum
- RBUSBR plus 0.75% per annum
- BA Equivalent Rate plus 2.25% per annum
- LIBOR Rate plus 2.25% per annum

Interest rate for advances made on the additional USD$35,000,000 borrowing capacity up to USD$58,000,000.

- RBP plus 0.00% per annum
- RBUSBR plus 0.00% per annum
- BA Equivalent Rate plus 0.875% per annum
- LIBOR Rate plus 0.875% per annum

Drawdown under the USD$35,000,000 additional borrowing capacity is supported by a major and material customer of the Company by way of a guarantee.

The Company will provide the guarantor, as consideration for the guarantee, a fee equal to 5.375% of the weighted average outstanding balance of the guaranteed portion over each full twelve (12) month period commencing on the funding date plus, for the partial year thereafter, 5.375% of the weighted average outstanding balance of the guaranteed portion multiplied by the number of days in the partial year divided by three hundred sixty (360). The fee will be payable on the maturity date.

The revolving loan is subject to security agreements with a Canadian Chartered bank and with its guarantor. This debt facility is secured by a charge and specific registration over all of the assets of the Company.

At year end Avcorp Group's operating line of credit provides for a total utilization of USD$58,000,000 (providing approximately CAD$72,761,000 million of liquidity). Avcorp Group ended 2017 with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 and $3,960,000 cash on hand at December 31, 2016. Based on net collateral provided to its bank, Avcorp Group is able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

On April 7, 2017, a term loan entered into with Panta become due and payable for the principal amount of USD$5,000,000 and USD$187,000 of accrued and unpaid interest. As at that date the Company and Panta amended the term loan to provide for a maturity date which is the earlier of the date on which credit is available to be drawn by the Company under the revolving loan with a Canadian Chartered bank, and July 6, 2017, with interest continuing at 8% per year. The Company incurred a USD$100,000 amendment fee in this regard. Effective July 6, 2017 the Company and Panta further amended the term loan to provide for a maturity date which is the earlier of (i) the date upon which, for any reason, the outstanding principal balance of the operating credit facility with a Canadian Chartered bank becomes due and owing and (ii) the date on which all or substantially all the assets of Comtek are sold by the Borrower or a controlling interest in the shares of Comtek is sold by the Borrower, in each case by a transaction or series of transactions, and (iii) July 6, 2021.

As at July 7, 2017 the Panta term loan bears interest at the aggregate rate of interest, expressed as an annual rate, of the U.S. Base Rate of Royal Bank of Canada (RBUSBR) plus a margin of 5.375% per annum which shall accrue and not be compounded until the maturity date.

On July 31, 2017 the Company repaid a principal amount of USD$2,500,000 plus interest accrued in the amount of USD$285,000 of the Panta term loan.

On August 3, 2017 Panta exercised 12,105,327 warrants expiring August 17, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.

On August 25, 2017 Panta exercised 6,052,664 warrants expiring September 9, 2017 at $0.07 whose aggregate price of $424,000 was deemed to be made by way of set-off against the Panta loan obligation.

On September 8, 2017 Panta exercised 12,105,327 warrants expiring September 23, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.

On December 18, 2015, in conjunction with the acquisition of Hitco, the Company assumed a customer advance for pre-funded product deliveries. The customer advance is re-paid as the Company delivers to the customer. In the event that cancellation, termination, or assignment of the statement of work occurs earlier than December 31, 2018 the customer shall have the right to recover from the Company within 120 days of such an event the unamortized portion of the cash advance. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company's bank and customer.

The customer advance was recorded at its fair value on December 18, 2015 in the amount of $18,953,000. The remaining unamortized customer advance has been discounted to arrive at the December 31, 2017 amount of $7,227,000 (December 31, 2016: $11,573,000) of which it is estimated $7,227,000 (December 31, 2016: $8,034,000) will be amortized during the next twelve months. The Company amortized into revenue $3,702,000 of the customer advance during the year ended December 31, 2017 (December 31, 2016: $6,287,000).

During the year ended December 31, 2017, the Company incurred a net loss of $58,538,000 (December 31, 2016: $19,959,000) and had negative operating cash flows of $42,604,000 (December 31, 2016: negative $50,347,000); as at December 31, 2017, the Company had a shareholders' deficiency of $57,405,000 (December 31, 2016: $6,883,000 deficiency) and an accumulated deficit of $157,185,000 (December 31, 2016: $98,647,000). Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. Material uncertainties have been identified which may cast significant doubt upon the Company's ability to continue as a going concern. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.

The Company's ability to continue as a going concern is dependent upon its ability to continue to raise adequate financing and achieve significant improvements in operating results in the future. In assessing whether the going concern assumption was appropriate, management took into account all relevant information available about the future, which was at least, but not limited to, the 12 month period from December 31, 2017. The Company, in conjunction with its Board of Directors, is currently implementing various financing strategies which include:

- On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank. This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012. This Revolving Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at June 30, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The loan agreement matures on June 30, 2020.

- On March 28, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendments were made:
  - Availability under the Revolving Loan is increased by USD$10,000,000 ("Expanded Loan") subject to existing drawdown provisions, interest rates and bonus fees;
  - Drawdowns under the Expanded Loan are supported by a major and material customer of the Company by way of a guarantee; and
  - The Expanded Loan matures on March 31, 2019.
- On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendment was made:
  - Maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.

The Company ended the year with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company was able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.

The Company, in conjunction with is Board of Directors continue to carry out various operational strategies which include:

- Operating and warranty issues at ACF were the largest cause of the Company's 2016 losses. Technical quality issues which were discovered by the Company soon after the Hitco acquisition created additional compliance costs during 2016. Management has resolved these technical quality issues such that they did not re-occur in 2017 and going forward. Furthermore, the Company has received notification from its customers that these quality issues have been appropriately resolved. All personnel resources and support service provider costs incurred during 2016 as a result of these issues have been terminated. The significant product scrap and re-work costs have been processed and expensed and one-time expenditures for equipment upgrades have been completed.
- Numerous process improvements initiatives, restructuring activities and supplier contract renegotiations have significantly reduced production costs on a go forward basis. These cost reduction initiatives have included significant headcount reductions, relative high points in 2016, the latest of which were announced in April 2017 and continue through the second half of 2017 and into 2018.
- Contract renegotiations with customers and new customer contracts have provided an improved basis for operations in the future.
- Close collaboration with customers has resulted in both financial and operational support for continued operations.

The assessment of the Company's ability to execute its strategy of reducing operating costs and funding future working capital requirements involves significant judgement. Estimates and assumptions regarding future operating costs, revenue and profitability levels and general business and customer conditions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Management is actively working to secure additional production orders, extension to its banking agreements, will continue to work with existing common shareholders, and will seek additional financing as necessary.

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.

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital, decreased by $42,257,000 during the year ended December 31, 2017 as compared to a $59,091,000 decrease of cash during the year ended December 31, 2016. Cash flows from operating activities were most significantly impacted as a result of operating losses incurred from the integration and production costs expended for the acquired Hitco operations, losses arising from unfavourable customer contracts assumed, and operational, administrative, and legal expenditures, incurred at Avcorp's Gardena facility as well as new program introduction and start-up costs at the Delta facility. Additional provisions for onerous contracts amounting to $13,366,000 during 2017 have caused operating results to deteriorate. Such contracts are being wound down in 2018; or completed in 2019.

Non-cash operating assets and liabilities utilized $347,000 of cash during the current year, compared to providing $8,744,000; accounts receivable provided cash and accounts payable used cash in 2017 compared to 2016 during which accounts receivable and payable provided cash.

Avcorp Group continues to closely monitor accounts receivable and work with its customers in order to ensure cash is collected on a timely basis.

Cash Flows from Investing Activities

During the year ended December 31, 2017, Avcorp Group collected $12,378,000 in consideration receivable from the Hitco acquisition; while cash consideration received from this source in 2016 totalled $22,429,000.

During the year ended December 31, 2017, the Avcorp Group purchased capital assets totalling $2,869,000 compared with $5,129,000 during the year ended December 31, 2016. Avcorp Group continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

In order to improve operational reporting, measurements, and business management in Gardena, Avcorp Group is expending funds on integrating the Gardena facility business systems with those in Delta. Such costs of integration during 2017 amounted to $571,000.

During 2016 and 2017, the Company commenced the new program introduction process in support of the newly awarded production contracts. The start-up of new production contracts requires significant investments in hard and soft tooling. Such tooling investments amounted to $5,347,000 in 2017 (December 31, 2016: $2,617,000).

Cash Flows from Financing Activities

Avcorp Group finances working capital through a combination of bank debt and equity financings.

Cash flows from financing activities provided $40,739,000 of cash during the current year compared with providing $23,527,000 of cash in 2016. The Company's operating line was $61,283,000 drawn as at December 31, 2017 (December 31, 2016: $17,111,000) providing $46,872,000 in cash during the year.

On March 17, 2017, Avcorp entered into a loan agreement with Panta to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The loan was repaid on April 3, 2017 from the proceeds of the consideration receivable.

On September 19, 2016, Avcorp entered into a non-revolving term loan agreement with Panta to fund the Company to a maximum aggregate principal amount of USD$5,000,000. On July 21, 2017, the Company repaid a principal amount of USD$2,500,000 plus interest accrued in the amount of USD$285,000 of the Panta term loan.

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 68.6% of the issued and outstanding common shares on December 31, 2017. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

Under the SADI program from the Government of Canada, the Company was able to secure $260,000 in project financing (December 31, 2016: $111,000).

On December 31, 2017, the ratio of the Company's current assets to current liabilities was 0.53:1 (December 31, 2016: 0.94:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

(expressed in thousands of Canadian dollars)

	Total	2018	2019 – 2021	2022 – 2023	Post 2023
Finance lease obligations	**$218**	$79	$139	$-	$-
Term loan	**1,237**	118	30	1,089	-
Other long-term obligations[1]	**1,715**	-	104	197	1,414
Purchase obligations[2]	**66,233**	43,227	7,147	4,707	11,152
Total contractual obligations	**69,403**	43,424	7,420	5,993	12,566

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

The Company expects that payment of contractual obligations will come from funds generated by operations, utilization of the bank operating line of credit, cash on hand 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, 2017, there were 337,404,502 common shares, 30,714,118 common share purchase warrants, and 49,532,500 stock options issued and outstanding. No subsequent issuance of common shares has occurred to the date of this report.

Common Shares

During the third quarter 2017 holders of the Company's warrants exercised 30,263,318 warrants at a price of $0.07 resulting in the issuance of 30,263,318 common shares with a value of $2,118,000.

Panta Canada B.V., is 100% owned by Panta Holdings B.V. and is Avcorp's majority shareholder owning approximately 68.6% of issued and outstanding common shares as of December 31, 2017.

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 337,404,502 common shares issued at December 31, 2017. The book value of common shares issued and outstanding as at December 31, 2017 was $82,905,000 (December 31, 2016: $80,302,000).

Accounting standards issued but not yet effective

The following is a brief summary of the new standards issued but not yet effective:

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 presents new requirements for the recognition of revenue, replacing IAS 18 "Revenue", IAS 11 "Construction Contracts", and several revenue-related Interpretations. The new standard establishes a control-based revenue recognition model and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for arrangements with multiple performance obligations, variable pricing, customer refund rights, supplier repurchase options, and other common complexities.

The Company is in the process of evaluating the impact of adopting these standards on the Company's consolidated financial statements. IFRS 15 permits either a full or modified retrospective approach for the adoption and is effective for annual periods beginning on or after January 1, 2018.

The Company has undertaken a project to assess the impact of IFRS 15 and ensure the Company's compliance with IFRS 15. The Company has collected an inventory of significant contracts with customers in scope for IFRS 15 assessment and identified preliminary accounting topics that may impact the Company's reported results based on the review of a sample of contracts from each revenue stream. The Company is in the process of reviewing contracts with customers to ensure revenue recognition practices are in accordance with IFRS 15 and evaluating potential changes to revenue processes and systems. The Company has identified contracts in which performance obligations are satisfied over time as control transfers during production. For these contracts, the revenue recognition pattern will change with revenue being recognized earlier in the year of adoption as compared to under the previous accounting policy. Contracts that do not meet the criteria for over time recognition will continue to be recognized at a point in time.

The Company continues to assess the impact of this standard on the consolidated financial statements and it is not yet in a position to make a reliable estimate of its impact. The Company plans to disclose the estimated financial effects of the adoption of IFRS 15 in its March 31, 2018 quarterly consolidated financial statements.

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments ("IFRS 9") 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. The Company plans to adopt the new standard on the required effective date and will not restate comparative information.

The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements. Overall, the Company expects no significant impact on its statement of financial position and equity except for the effect of applying the impairment requirements of IFRS 9.

IFRS 16 - Leases

In January 2016, the IASB issued IFRS 16 – Leases ("IFRS 16") which replaces IAS 17 – Leases and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, distinguishing between a lease and a service contract on the basis of whether the customer controls the asset being leased. For those assets determined to meet the definition of a lease, IFRS 16 introduces significant changes to the accounting by lessees, introducing a single, on-balance sheet accounting model that is similar to current finance lease accounting, with limited exceptions for short-term leases or leases of low value assets. Lessor accounting remains similar to current accounting practice. The standard is effective for annual periods beginning on or after January 1, 2019, with early application permitted for entities that apply IFRS 15. The Company plans to adopt the new standard on the required effective date. The Company has not yet assessed the impact the final standard is expected to have on its consolidated financial statements.

IFRS 2 – Share Based Payments

In 2016, the IASB issued the final amendments to IFRS 2, Share-based Payments ("IFRS 2") that clarify the classification and measurement of share-based transactions, consisting of: accounting for cash-settled share-based payment transactions that include a performance condition; classification of share-based payment transactions with net settlement features; accounting for modifications of share-based payment transactions from cash-settled to equity-settled. The amendments are effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. The amendments are to be applied prospectively. However, retrospective application is allowed if this is possible without the use of hindsight. The Company plans to adopt the new standard on the required effective date and will apply the amendments prospectively. The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements.

IFRIC Interpretation 22 – Foreign Currency Transactions and Advance Consideration

In 2016, the IASB issued IFRIC Interpretation 22, Foreign Currency Transactions and Advance Consideration ("IFRIC 22"), which provides requirements about which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. On initial application, entities have the option to apply either retrospectively or prospectively. The Company plans to adopt the new standard on the required effective date and will apply the amendments prospectively. The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2017 for Canadian manufacturing operations were at customer required levels. The manufacturing operations have achieved, and continue to maintain, top quality and delivery ratings for the majority of their programs.

In conjunction with the Hitco acquisition, Hitco and its ultimate parent, SGL Carbon SE, have the contractual responsibility and liability for certain losses incurred by Avcorp in connection with quality and warranty claims pertaining to finished goods delivered by Hitco before the closing date and certain finished goods manufactured by Hitco before the closing date that were designated as conforming inventory. Immediately after the Hitco acquisition, a thorough quality and delivery review and audit was conducted of Hitco's Gardena manufacturing operations by ACF, which has produced improvement plans together with its customers. ACF continues to work collaboratively with customers to ensure any quality and delivery issues are resolved at the earliest date, as it continues to achieve quality and delivery requirements.

Order Backlog

Avcorp Group 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 2018 to December 2022; additional production contracts entered into during 2015 and 2016 extend to 2028 and 2025 respectively. Production contracts underlying Boeing's general term agreements, which were assigned to Avcorp with the Hitco acquisition, extend to 2019.

Agreements with Boeing Defense, Space and Security extend into 2020 with established minimum base delivery quantity requirements.

The Bombardier and Subaru agreements extend for the life of the individual aircraft programs.

Agreements with Lockheed Martin extend into 2019, with negotiations occurring for follow-on orders to existing statements of work through to 2020.

Agreements with BAE Systems (Operations) Limited extend into 2019 and continue to generate additional sales order backlog.

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. Order backlog is a financial measure not recognized as a term under IFRS. However, the Avcorp's management believes that the Company's stakeholders consider this metric to be useful information to assist them in evaluating profitability. The order backlog, as at December 31, 2017, is $879 million in consideration of attaining full award values, compared to $826 million as at December 31, 2016. The changes in order backlog are as follows:

- $149 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2017;
- $249 million increase in order backlog due to increases in the production rates, contract renewals for various existing programs, and contract awards; and
- $47 million decrease 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. 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. Critical supplier cost reduction initiatives are continuing through 2017 and into the future.

Working Capital Utilization

Total current assets less total current liabilities were in a deficit position of $63,613,000 at December 31, 2017 and a $5,439,000 deficit position at December 31, 2016. Working capital decreased during 2017 as consideration receivable was collected, and bank indebtedness increased due to repayment of suppliers and operating losses. However, the Company's accounts receivable and inventories net of accounts payable, amount to a $37,889,000 surplus as at December 31, 2017 (December 31, 2016: $38,436,000 surplus).

Financial Resources

Avcorp Group has invested in its chosen strategies of organic growth, capabilities acquisition, lean manufacturing and strategic outsourcing. Management believes that significant investments necessary to better position Avcorp Group 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 number of employees at December 31, 2017 was 728 (December 31, 2016: 722).

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 Avcorp Group 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, composite materials, 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; and
- increase in the value of the Canadian dollar, relative to the US dollar, has an adverse effect on the US dollar equivalent value of those Company procured goods and services which are denominated in Canadian 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

Avcorp Group'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 transitional operating losses incurred upon integration of acquired entities;
- finance new program development and introduction;

- develop or enhance existing services and capabilities;
- respond to competitive pressures; or
- finance business acquisitions.

On May 26, 2017, the Company entered into a loan agreement to expand its existing credit facility by an additional borrowing capacity of up to USD$35,000,000; providing a total borrowing capacity of USD$58,000,000 until June 30, 2020.

On March 28, 2018, the Company entered into an amendment to its existing credit facility, which provides an additional borrowing capacity of up to USD$10,000,000 and is due on March 31, 2019.

On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.

The Company ended the year with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company was able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.

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. Avcorp Group operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's agreements with Boeing CA extend from current date, with various expiry timelines, through to the end of 2028. Agreements with Boeing DSS have been renewed and established which extend into 2020 with minimum base quantity requirements. It is the Company's objective to successfully renew Boeing production contracts in advance of expiry dates.

The Bombardier and Subaru agreements extend for the life of the individual aircraft programs.

BAE and Lockheed Martin customer contracts extend into 2019. 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 and is now commencing to be awarded new customer production contracts.

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 2017. The lighter business jets' market is expected to show modest growth.
- 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 CL650 aircraft production requirements increased in 2017 relative to 2016, and are forecasted to remain substantially flat through 2020.
- The growth in the global market for defence aircraft although slowed, continued through 2017 with continued growth expected in 2018.
- The F-35 remains, on a global scale, one of the largest Defence Airplane programs for the foreseeable future.
- Offset opportunities created by Canadian Government procurement within military aerospace programs such as the Boeing F-18 and Airbus C295 FWSAR could lead to additional revenue opportunities from this aerospace sector.

Competitors

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 60% of Avcorp Group's cost of sales is related to labour and overhead and 40% 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 labour force, at the Delta facility ratified a six-year collective agreement. The agreement was ratified by a two-thirds majority, with the agreement expiring on March 31, 2019. Subsequent to the Hitco acquisition the Company and the labour force, in Gardena, agreed to a four month extension of the current collective agreement, which was to expire February 29, 2016. On June 29, 2016 the labour force at the Gardena facility ratified a six-year collective agreement, adding language that allows for High Performance Work Teams and incentive bonus payments for accomplishing annual targets regarding operational and quality performance.

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.

US Dollar Revenues

Avcorp Group sells a significant proportion of its products in US dollars, partially from its Canadian operations and entirely within its United States operations, 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. It should be noted that a significant portion of the Company's purchases of raw materials, supplier fabricated parts, as well as equipment purchases, are denominated in US dollars.

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. Also, the Company continues to work towards securing additional defence program production contracts in order to augment and diversify its backlog. The Company began delivering products under its defence contracts in 2009 and continues to negotiate long-term supply agreements. Both defence and commercial production contracts are being renewed, with select new customer agreements extending into 2028. The Company expects to finance investment in the start-up of new production programs primarily by milestone payments from customers, though this cannot be assured. Avcorp Group may require financing for capital expenditures and start-up costs required for new programs.

Boeing is the Company's largest customer in 2017, followed by Subaru, Bombardier, Lockheed Martin and BAE Systems. The Company forecasts its 2018 revenues to increase due to orders received for defence related program deliveries, and Delta production ramp-up for recently awarded contracts (exclusive of the amortization into revenue of the unfavourable contract liability).

The Company forecasts its working capital financing requirements for 2017 to be met by the operating line of credit, and working capital surplus (exclusive of Bank indebtedness). Working capital financing has been supplemented, as well, by shareholder loans and consideration received as a result of the Hitco acquisition. However, further debt and equity financing may be required.

On March 28, 2018, the Company entered into an amendment to its existing credit facility ("Revolving Loan") with a Canadian chartered bank whereby the following amendments were made:

- Availability under the Revolving Loan is increased by USD$10,000,000 ("Expanded Loan") subject to existing drawdown provisions, interest rates and bonus fees;
- Drawdowns under the Expanded Loan are supported by a major and material customer of the Company by way of a guarantee; and
- The Expanded Loan matures on March 31, 2019.

On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendment was made:

- Maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.
- Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.

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.

Transactions with Related Parties

During the year ended December 31, 2017, 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, 2017 amounted to $437,000 (December 31, 2016: $337,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2017 are $Nil (December 31, 2016: $376,000). These fees are included in the Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amount to $61,000 for the year ended December 31, 2017 (December 31, 2016: $701,000).

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

KEY MANAGEMENT COMPENSATION

(expressed in thousands of Canadian dollars)

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Salaries and other short-term employee benefits	**$2,285**	$2,186
Contributions to defined contribution plan	**75**	69
Option-based awards	**659**	1,332
	3,019	3,587

The balance of loans receivable from key management as at December 31, 2017 is $15,000 (December 31, 2016: $15,000). These loans are unsecured and payable on demand.

On March 17, 2017, Avcorp entered into a loan agreement ("Loan") with Panta Canada B.V. ("Panta") bearing interest of 8% per annum to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The Loan was repaid on April 3, 2017 from the proceeds of the consideration receivable.

On April 7, 2017, a term loan entered into with Panta become due and payable for the principal amount of USD$5,000,000 and USD$187,000 of accrued and unpaid interest. As at that date the Company and Panta amended the term loan to provide for a maturity date which is the earlier of the date on which credit is available to be drawn by the Company under the revolving loan with a Canadian Chartered bank, and July 6, 2017, with interest continuing at 8% per year. The Company incurred a USD$100,000 amendment fee in this regard.

Effective July 6, 2017 the Company and Panta amended the term loan to provide for a maturity date which is the earlier of (i) the date upon which, for any reason, the outstanding principal balance of the revolving loan with a Canadian Chartered bank becomes due and owing and (ii) the date on which all or substantially all the assets of Comtek are sold by the Borrower or a controlling interest in the shares of Comtek is sold by the Borrower in each case by a transaction or series of transactions, and (iii) July 6, 2021.

As at July 7, 2017 the loan bears interest at the aggregate rate of interest, expressed as an annual rate, of the U.S. Base Rate of Royal Bank of Canada (RBUSBR) plus a margin of 5.375% per annum which shall accrue and not be compounded until the maturity date.

On July 31, 2017 the Company repaid a principal amount of USD$2,500,000 plus interest accrued in the amount of USD$285, 000 of the Panta term loan.

On August 3, 2017 Panta exercised 12,105,327 warrants expiring August 17, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.

On August 25, 2017 Panta exercised 6,052,664 warrants expiring September 9, 2017 at $0.07 whose aggregate price of $424,000 was deemed to be made by way of set-off against the Panta loan obligation.

On September 8, 2017 Panta exercised 12,105,327 warrants expiring September 23, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation.

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

Business Acquisition

Effective December 18, 2015, Avcorp completed the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc. ("Hitco"), a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL") (the "Acquisition"). The Acquisition was completed pursuant to the terms of an asset purchase agreement (the "Agreement") that was entered into on July 20, 2015, with subsequent amendments to December 18, 2015. Pursuant to the Agreement Avcorp's subsidiary, Avcorp Composite Fabrication Inc., purchased the assets of the division of Hitco which produces composite structural parts for commercial and military aerostructures (the "Business").

Pursuant to the Agreement, Hitco and SGL are subject to a non-competition clause within the United States and a non-solicitation clause for a period of five years. As part of the Acquisition, Avcorp also leased certain real property owned by Hitco, which Avcorp will use to conduct the Business.

As a result of potential product quality and warranty claims, in addition to the liabilities assumed in the transaction, the Company may be involved in, or subject to, other disputes, claims and proceedings that arise in connection with the business acquired, including some that Avcorp asserts against others. The ultimate resolution of, and liability and costs related to these matters, at this time is undeterminable.

Pursuant to the asset purchase agreement, Hitco's direct and indirect parent companies have guaranteed certain of Hitco's obligations to Avcorp under the Agreement, including Hitco's indemnity obligations to Avcorp for Avcorp's losses stemming from product quality and warranty claims pertaining to finished goods delivered by Hitco before the closing date and certain finished goods manufactured by Hitco before the closing date that were designated as conforming inventory.

Consideration provided by Avcorp for the Acquisition of the assets was principally the assumption of liabilities by Avcorp, including the current trade payables and ongoing contractual obligations of the Business.

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

Fourth Quarter

The following summarizes unaudited financial results for the fourth quarter 2017.

Operating loss for the fourth quarter of 2017 was $27,342,000 from $37,923,000 in revenues, as compared to operating income of $9,233,000 from $46,183,000 in revenues for the quarter ended December 31, 2016. The Company expensed $1,013,000 of overhead costs during the fourth quarter 2017 (2016: $1,317,000) in respect of unutilized plant capacity. Included in the calculation of operating income for the fourth quarter 2017 is the amortization and contract renegotiation of the unfavourable contract liability of $2,139,000 into income (fourth quarter 2016: $13,658,000). Provisions for onerous contracts accrued during the fourth quarter 2017 totalled $13,603,000.

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. The critical estimates and judgements utilized in preparing the Company's consolidated financial statements affect the assessment of net recoverable amounts, net realizable values and fair values, and the determination of functional currency of the Canadian operations of the group. Any changes in estimates and assumptions could have a material impact on the assets and liabilities at the date of the statement of financial position. The Company reviews its estimates and assumptions on an ongoing basis and uses the most current information available and exercises careful judgement in making these estimates and assumptions.

- Functional currency: The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which each operates. The Company has determined that the functional currency for the Company and all its subsidiaries except for Avcorp US Holdings Inc. and Avcorp Composite Fabrication Inc. is the Canadian dollar. The functional currency for Avcorp US Holdings Inc. and Avcorp Composite Fabrication Inc. is the US dollar. The determination of functional currency may require certain judgements to determine the primary economic environment. The Company reconsiders the functional currency used when there is a change in events and conditions which determined the primary economic environment.
- Impairments: The recoverable amount of intangible assets, development costs and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each CGU or group of CGUs. In order to estimate the fair value of indefinite-lived intangible assets and goodwill resulting from business combinations, the Company typically estimates future revenue, considers market factors and estimates future cash flows. Based on these key assumptions, judgments and estimates, the Company determines whether to record an impairment charge to reduce the value of the asset carried on the consolidated statement of financial position to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Company's business strategy or internal forecasts. Although the Company believes the assumptions, judgments and estimates made in the past have been reasonable and appropriate, different assumptions, judgments and estimates could materially affect the Company's reported financial results.
- Going Concern: 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.
- Capitalization of development costs: When capitalizing development costs the Company must assess the technical and commercial feasibility of the projects and estimate the useful lives of resulting products. Determining whether future economic benefits will flow from the assets and therefore the estimates and assumptions associated with these calculations are instrumental in (i) deciding whether project costs can be capitalized, and (ii) accurately calculating the useful life of the projects for the Company.
- Unfavourable contracts liability: At the acquisition date management valued the unfavourable contracts liability at fair value using certain assumptions that would arise in a market participant view. The Company estimates the expected shipsets of production when assessing the liability, together with the discounts rate and period of performance under the varying contracts and service agreements. The cash flows are discounted over the period of performance using a discount rate commensurate with the risk associated with the liability.

- Fair value of assets and liabilities acquired in a business combination: The Company accounted for the acquisition of ACF using the acquisition method when control is transferred to the Company. The consideration received is generally measured at fair value, as are the identifiable net liabilities assumed. The fair value of the liabilities assumed is determined using valuation techniques that require estimation of the estimated cash flows, discount rates and estimated operating margins.
- Inventories are valued at the lower of cost and net realizable value. The costs of inventory involve estimates in determining the allocation of fixed and variable production overhead. The estimates involved include determination of normal production capacity and nature of expenses to be allocated. Additionally inventory is reviewed monthly to ensure the carrying value does not exceed net realizable value. If so, a write-down is recognized. The write-down may be reversed if the circumstances which caused it no longer exist
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $4,309,000 of overhead costs during the current year (December 31, 2016: $4,408,000) in respect of unutilized plant capacity. These amounts are included in the Consolidated Statements of Loss and Comprehensive Loss as costs of sales.
- The Company has entered into production contracts in the ordinary course of its business. The unavoidable cost of meeting the obligations under certain of these contracts exceeds the associated expected future net benefits; consequently, an onerous contract provision has been recognized. The calculation of this provision involves the use of estimates including, but not limited to, program gross margin, and the effect of learning curves of production and the timing of achieving certain operational efficiencies. These actual results can vary significantly from these estimates with consequent variability in the amounts of the provision recorded. The onerous contract provision is calculated by taking the expected future costs that will be incurred under the contract and deducting any estimated revenues. A portion of the onerous contract provision is for costs incurred that were greater than the expected future costs used to determine the fair value of the unfavourable contract liability; this portion of the onerous contract provision for the year ended December 31, 2017 is $3,479,000. The remaining portion of the onerous contract provision is primarily due to a high cost structure and learning curves of production that cannot be recovered through current pricing of the associated contracts. The current portion of the onerous contract provision for the year ended December 31, 2017 is $7,297,000. The onerous contract provision for the year ended December 31, 2017 is $13,366,000 (December 31, 2016: $37,000).

Financial Instruments and Other Instruments

Market Risk

Market risk is the risk that changes in the market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holdings of financial instruments. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes. The Company may utilize derivative instruments in the management of its foreign currency and interest rate exposures.

Currency Risk

Currency risk arises because the amount of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rate ("transaction exposures") and because the non-Canadian dollar denominated financial statements of the Company's subsidiaries may vary on consolidation into the reporting currency of Canadian dollars ("translation exposures").

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 and components in US dollars at prices that are usually established at the order date. The Company's operations are based in Canada and in the US. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange loss recorded for the year ended December 31, 2017 is $1,944,000 (December 31, 2016: $3,278,000 loss).

The Company had the following US dollar denominated balances as at December 31, 2017 and as at December 31, 2016:

CURRENCY RISK

(expressed in thousands of dollars)

FOR THE YEAR ENDED DECEMBER 31	**2017** (expressed in USD)	2016 (expressed in USD)
Bank cash position	**$2,929**	$1,205
Accounts receivable	**9,749**	15,278
Consideration receivable	**-**	9,124
Accounts payable net of prepayments	**2,111**	1,574
Bank indebtedness	**48,851**	4,250
Term debt	**868**	4,560

With other variables unchanged, each $0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately $3,915,000 in net income for the year ended December 31, 2017 as a result of holding a net liability position in USD as at December 31, 2017.

As at December 31, 2016, a $0.10 strengthening (weakening) of the CAD against the USD would result in a (decrease) increase of approximately $1,522,000 in net income for the year ended December 31, 2016 as a result of holding a net USD asset position in USD as at December 31, 2016.

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"), BAE Systems (Operations) Limited ("BAE"), Lockheed Martin ("LM"), and Subaru Corporation ("Subaru"). The maximum exposure to credit risk is represented by the amount of cash, accounts receivable in the consolidated statements of financial position.

As at the consolidated statements of financial position date 86.6% (December 31, 2016: 69.8%) of the Company's trade accounts receivable are attributable to these customers.

The Company is exposed to credit risk if counterparties to its trade receivables are unable to meet their obligations. The concentration of credit risk from its customers is minimized because the Company has an original equipment manufacturer and tier one aerospace customer base as at December 31, 2017. The customers are predominately large, well-capitalized, and long established entities with a low risk of non-payment. The Company regularly monitors its credit risk and credit exposure.

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.

During the year ended December 31, 2017, the Company incurred a net loss of $58,538,000 (December 31, 2016: $19,959,000) and had negative operating cash flows of $42,604,000 (December 31, 2016: negative $50,347,000); as at December 31, 2017, the Company had a shareholders' deficiency of $57,405,000 (December 31, 2016: $6,883,000 deficiency) and an accumulated deficit of $157,185,000 (December 31, 2016: $98,647,000). Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. Material uncertainties have been identified which may cast significant doubt upon the Company's ability to continue as a going concern. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.

The Company's ability to continue as a going concern is dependent upon its ability to continue to raise adequate financing and achieve significant improvements in operating results in the future. In assessing whether the going concern assumption was appropriate, management took into account all relevant information available about the future, which was at least, but not limited to, the 12 month period from December 31, 2017. The Company, in conjunction with its Board of Directors, is currently implementing various financing strategies which include:

- On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank. This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012. This Revolving Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at June 30, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The loan agreement matures on June 30, 2020.
- On March 28, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendments were made:
  - Availability under the Revolving Loan is increased by USD$10,000,000 ("Expanded Loan") subject to existing drawdown provisions, interest rates and bonus fees;
  - Drawdowns under the Expanded Loan are supported by a major and material customer of the Company by way of a guarantee; and
  - The Expanded Loan matures on March 31, 2019.
- On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendment was made:
  - Maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.

The Company ended the year with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company was able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.

On December 18, 2015, in conjunction with the acquisition of Hitco, the Company assumed a customer advance for pre-funded product deliveries. The customer advance is re-paid as the Company delivers to the customer. In the event that cancellation, termination, or assignment of the statement of work occurs earlier than December 31, 2018 the customer shall have the right to recover from the Company within 120 days of such an event the unamortized portion of the cash advance. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company's bank and customer.

The customer advance was recorded at its fair value on December 18, 2015 in the amount of $18,953,000. The remaining unamortized customer advance has been discounted to arrive at the December 31, 2017 amount of $7,227,000 (December 31, 2016: $11,573,000) of which it is estimated $7,227,000 (December 31, 2016: $8,034,000) will be amortized during the next twelve months. The Company amortized into revenue $3,702,000 of the customer advance during the year ended December 31, 2017 (December 31, 2016: $6,287,000).

The Company, in conjunction with is Board of Directors continue to carry out various operational strategies which include:

- Operating and warranty issues at ACF were the largest cause of the Company's 2016 losses. Technical quality issues which were discovered by the Company soon after the Hitco acquisition created additional compliance costs during 2016. Management has resolved these technical quality issues such that they did not re-occur in 2017 and going forward. Furthermore, the Company has received notification from its customers that these quality issues have been appropriately resolved. All personnel resources and support service provider costs incurred during 2016 as a result of these issues have been terminated. The significant product scrap and re-work costs have been processed and expensed and one-time expenditures for equipment upgrades have been completed.
- Numerous process improvements initiatives, restructuring activities and supplier contract renegotiations are expected to significantly reduce production costs on a go forward basis. These cost reduction initiatives include significant headcount reductions, relative to high points I 2016, the latest of which were announced in April 2017 and continue through the second half of 2017 and into 2018.
- Contract renegotiations with customers and new customer contracts have provided an improved basis for operations in the future.
- Close collaboration with customers has resulted in both financial and operational support for continued operations.

The assessment of the Company's ability to execute its strategy of reducing operating costs and funding future working capital requirements involves significant judgement. Estimates and assumptions regarding future operating costs, revenue and profitability levels and general business and customer conditions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Management is actively working to secure additional production orders, extension to its banking agreements, will continue to work with existing common shareholders, and will seek additional financing as necessary.

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.

Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit.

Interest rate for advances made up to the maximum of the allowable borrowing base on the existing USD$23,000,000 revolving loan:

- RBP plus 0.75% per annum
- RBUSBR plus 0.75% per annum
- BA Equivalent Rate plus 2.25% per annum
- LIBOR Rate plus 2.25% per annum

Interest rate for advances made on the additional borrowing capacity up to USD$58,000,000.

- RBP plus 0.00% per annum
- RBUSBR plus 0.00% per annum
- BA Equivalent Rate plus 0.875% per annum
- LIBOR Rate plus 0.875% per annum

Drawdown under the USD$35,000,000 additional borrowing capacity is supported by a major and material customer of the Company by way of a guarantee.

The Company will provide the guarantor, as consideration for the guarantee, a fee equal to 5.375% of the weighted average outstanding balance of the guaranteed portion over each full twelve (12) month period commencing on the funding date plus, for the partial year thereafter, 5.375% of the weighted average outstanding balance of the guaranteed portion multiplied by the number of days in the partial year divided by three hundred sixty (360). The fee will be payable on the maturity date.

The maximum operating line of credit availability is $72,761,000 (USD$58,000,000) of which $61,283,000 is utilized as at December 31, 2017 (December 31, 2016: $17,111,000). The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the year ended December 31, 2017, with other variables unchanged, a 1% change in the base borrowing rate would have a $613,000 (December 31, 2016: $171,000) impact on net earnings and cash flow.

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

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 Chief Financial Officer that, among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting. These certificates can be found on www.sedar.com.

The Company has continued to undertake to engage additional, qualified financial reporting expertise to assist with complex accounting matters, as well as develop the expertise of in-house staff ensuring that the Company's tax accounting resources, processes and controls are designed and operating effectively. Furthermore, the Company is aligning its business systems within its two largest facilities in order to simplify and increase consistency of internal controls over financial reporting.

Internal Controls over Financial Reporting

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, the Company's internal controls over financial reporting ("ICFR") in order to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS"). The CEO and CFO have evaluated the effectiveness of the Company's ICFR as at December 31, 2016 based on Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). During the course of this review, the CEO and CFO determined that there were material weaknesses in the Company's ICFR related to the accounting for the complex accounting transaction arising from the 2015 Hitco acquisition, which resulted in the reclassification of foreign exchange gains and losses in prior years filed financial statements, as well as integrating the related accounting systems, particularly inventory systems that may result in inaccuracies in financial reporting. Management mitigated these weaknesses by utilizing outside consultants for assistance, by developing in-house expertise and/or by recruiting personnel with the necessary expertise; however, such mitigating procedures did not constitute a compensating control for the purposes of National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings. Based on the review of the Company's ICFR, the CEO and CFO determined that there was a reasonable possibility that the above deficiencies could have resulted in misstatements not being prevented or detected on a timely basis and therefore concluded they were material weaknesses. To remediate the foregoing specific issues for future reporting periods, the Company continues to undertake to engage additional, qualified financial reporting expertise to assist with any complex accounting matters, and has converted the ERP business system of the Gardena operations to Avcorp's existing business systems platform, as well as developed the expertise of in-house staff ensuring that the Company's inventory accounting resources, processes and controls are designed and operating effectively.

Disclosure Controls and Procedures ("DCP")

For the year ended December 31, 2016, the CEO and the CFO have designed, or caused to be designed under their supervision, the Company's DCP to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries has been recorded, processed, summarized and disclosed in a timely manner in accordance with regulatory requirements and good business practices and that the Company's DCP will enable the Company to meet its ongoing disclosure requirements. As described above, the Company has determined that there were material weaknesses in the design of its ICFR. As a result, the CEO and CFO have determined that, as a result, for the same reasons, the Company's DCP were also ineffective for this specific issue as at December 31, 2017. This issue will be remediated as described above.

Limitation of Controls and Procedures

The Company's CEO and CFO, believe that any DCP and ICFR, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override to the control. The design of any control system also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any control system will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective, control system, misstatements due to error or fraud may occur and not be detected.

Changes to DCP and ICFR The Company is required to disclose herein any change in the Company's internal control over financial reporting that occurred during the period beginning January 1, 2017 and ended on December 31, 2017 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting. No material changes in the Corporation's internal control over financial reporting were identified during such period that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control 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; (l) changes in aircraft delivery schedules, cancellation of orders or changes in production scheduling; (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") as issued by the International Accounting Standards Board ("IASB") 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 Discussion 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, management identified material weaknesses as described in the Management Discussion and Analysis under the heading "Other Items". 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 MERLO Chief Financial Officer and Corporate Secretary		**AMANDEEP KALER** Executive Officer and Group Chief Executive Officer

independent auditor's report

To the Shareholders of **Avcorp Industries Inc.**

We have audited the accompanying consolidated financial statements of Avcorp Industries Inc., which comprise the consolidated statement of financial position as at December 31, 2017, and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained 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, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 to the consolidated financial statements, which indicates that as at December 31, 2017, the Company had a shareholders' deficiency of $57,405,000 and an accumulated deficit of $157,185,000 and for the year ended December 31, 2017, the Company had a consolidated net loss of $58,538,000 and negative cash flows from operations of $42,604,000. These conditions, along with other matters as set forth in note 1, indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Other matter

The consolidated financial statements of Avcorp Industries Inc. as at and for the year ended December 31, 2016 were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on June 29, 2017 [July 10, 2018 as to the effects of the restatement discussed in note 33].

Ernst & Young LLP

Vancouver, Canada
July 10, 2018

Chartered Professional Accountants

independent auditor's report

To the Shareholders of **Avcorp Industries Inc.**

We have audited the accompanying consolidated financial statements of Avcorp Industries Inc., which comprise the consolidated statement of financial position as at December 31, 2016, and the consolidated statements of loss and comprehensive loss, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's 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 in our audit 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, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements, which indicates that as of December 31, 2016, the Company had a shareholders' deficiency of $6,883,000 and for the year ended December 31, 2016, the Company had a consolidated net loss of $19,959,000 and negative cash flows from operations of $50,347,000. These conditions, along with other matters as set forth in Note 1, indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

/s/ Deloitte LLP

Chartered Professional Accountants

June 29, 2017 (July 10, 2018 as to the effects of the restatement discussed in Note 33(i))
Vancouver, Canada

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(expressed in thousands of Canadian dollars)

AS AT DECEMBER 31	2017	2016
ASSETS (note 16)		
Current assets		
Cash (note 16)	**$5,212**	$3,960
Accounts receivable (note 9)	**18,942**	26,262
Consideration receivable (note 10)	**-**	12,251
Inventories (note 11)	**42,781**	44,296
Prepayments and other assets (note 12)	**4,390**	4,144
	71,325	90,913
Non-current assets		
Prepaid rent	**146**	146
Development costs (note 13)	**8,623**	5,200
Property, plant and equipment (note 14)	**29,318**	31,930
Intangibles (note 15)	**3,864**	4,887
Total assets	**113,276**	133,076
LIABILITIES AND EQUITY		
Current liabilities (note 23)		
Bank indebtedness (note 16)	**61,283**	17,111
Accounts payable and accrued liabilities (note 18)	**23,834**	32,122
Current portion of term debt (note 22)	**1,285**	6,283
Customer advance (note 17)	**7,227**	8,034
Deferred program revenues (note 19)	**17,131**	13,861
Unfavourable contracts liability (note 20)	**16,881**	18,904
Onerous contract provision (note 4)	**7,297**	37
	134,938	96,352
Non-current liabilities		
Deferred gain and lease inducement (note 21)	**100**	246
Term debt (note 22)	**1,885**	1,646
Customer advance (note 17)	**-**	3,539
Deferred program revenues (note 19)	**110**	111
Unfavourable contracts liability (note 20)	**27,579**	38,065
Onerous contract provision (note 4)	**6,069**	-
	170,681	139,959
(Deficiency) Equity		
Capital stock (note 24)	**82,905**	80,302
Contributed surplus (note 24)	**6,979**	6,744
Accumulated other comprehensive income (note 33)	**9,896**	4,718
Accumulated deficit (note 33)	**(157,185)**	(98,647)
	(57,405)	(6,883)
Total liabilities and (deficiency) equity	**113,276**	133,076

Nature of operations and going concern (note 1)
Subsequent events (note 34)

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

Approved by the Board of Directors on July 10, 2018

David Levi
Chairman

Ken Robertson
Committee Chair, Audit & Corporate Governance Committee

CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

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

AS AT DECEMBER 31	**2017**	2016
Revenues (notes 17, 20 and 32)	**$149,444**	$183,707
Cost of sales (note 32)	**181,296**	175,333
Gross (loss) profit	**(31,852)**	8,374
Administrative and general expenses	**21,580**	24,429
Office equipment depreciation	**341**	350
Operating Loss	**(53,773)**	(16,405)
Finance costs – net (note 27)	**2,806**	339
Foreign exchange loss (note 33)	**1,944**	3,278
Net loss (gain) on sale of equipment	**15**	(63)
Loss before income tax	**(58,538)**	(19,959)
Income tax expense (note 29)	**-**	-
Net loss for the period	**(58,538)**	(19,959)
Other comprehensive income (note 33)	**5,178**	3,857
Comprehensive loss for the period	**(53,360)**	(16,102)
Loss per share:		
Basic and diluted loss per common share (notes 31 and 33)	**(0.18)**	(0.07)
Basic and diluted weighted average number of shares outstanding (000's) (note 31)	**318,019**	306,611

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(expressed in thousands of Canadian dollars)

AS AT DECEMBER 31	2017	2016
Cash flows (used in) from operating activities		
Net loss for the year	**$(58,538)**	$(19,959)
Adjustment for items not affecting cash:		
Interest expense	**2,216**	322
Depreciation	**4,153**	3,915
Development cost amortization	**1,924**	604
Intangible assets amortization	**1,299**	1,325
Non-cash financing cost accretion	**589**	31
Loss (Gain) on disposal of equipment	**15**	(15)
Provision for unfavourable contracts	**(9,058)**	(38,937)
Provision for onerous contracts	**13,603**	(77)
Provision for doubtful accounts	**921**	189
Provision for obsolete inventory	**(678)**	(8,653)
Stock based compensation	**720**	1,158
Unrealized foreign exchange	**712**	1,135
Other items	**(135)**	(129)
Cash flows (used in) operating activities before changes in non-cash working capital	**(42,257)**	(59,091)
Changes in non-cash working capital		
Accounts receivable	**6,546**	7,129
Inventories	**869**	(614)
Prepayments and other assets	**(693)**	(3,994)
Accounts payable and accrued liabilities	**(6,636)**	6,705
Customer advance payable	**(3,702)**	(6,955)
Deferred program revenues	**3,269**	6,473
Net cash (used in) operating activities	**(42,604)**	(50,347)
Cash flows from (used in) investing activities		
Proceeds from consideration receivable	**12,378**	22,429
Proceeds from sale of equipment	**20**	60
Purchase of equipment	**(2,744)**	(5,129)
Addition of developed software	**(571)**	-
Payments relating to development costs and tooling	**(5,347)**	(2,617)
Net cash from (used in) investing activities	**3,736**	14,743
Cash flows from (used in) financing activities		
Increase in bank indebtedness	**46,872**	17,111
Payment of interest	**(1,331)**	(184)
Proceeds from term debt	**1,473**	6,727
Proceeds from issuance of common shares	**-**	113
Repayment of term debt	**(6,275)**	(240)
Net cash from financing activities	**40,739**	23,527
Net increase (decrease) in cash	**1,871**	(12,077)
Net foreign exchange difference	**(619)**	1,553
Cash - Beginning of the period	**3,960**	14,484
Cash - End of the period	**5,212**	3,960

Supplementary Cash Flow Information (note 28)

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(expressed in thousands of Canadian dollars, except number of shares)

	Capital Stock					
	Number of Shares	**Amount**	**Contributed Surplus**	**Deficit**	**Accumulated Other Comprehensive Income**	**Total Deficiency**
Balance at January 1, 2016 (note 33)	305,555,184	80,158	4,453	(78,688)	861	6,784
Issue of Common Shares (note 24)	1,586,000	113	-	-	-	113
Stock-based compensation expense (note 25)	-	-	1,578	-	-	1,578
Forfeiture of issued stock options (note 25)	-	-	(420)	-	-	(420)
Transfer to share capital on exercise of stock options	-	31	(31)	-	-	-
Fair value of warrants issued (note 24)	-	-	1,164	-	-	1,164
Unrealized currency gain on translation for the year (note 33)	-	-	-	-	3,857	3,857
Net loss for the year (note 33)	-	-	-	(19,959)	-	(19,959)
Balance December 31, 2016 (note 33)	307,141,184	80,302	6,744	(98,647)	4,718	(6,883)
Issue of common shares (note 24)	30,263,318	2,118	-	-	-	2,118
Transfer to share capital on exercise of warrants	-	485	(485)	-	-	-
Stock-based compensation expense (note 25)	-	-	718	-	-	718
Cancellation of issued stock options			2	-	-	2
Unrealized currency gain on translation for the year	-	-	-	-	5,178	5,178
Net loss for the year	-	-	-	(58,538)	-	(58,538)
Balance December 31, 2017	**337,404,502**	**82,905**	**6,979**	**(157,185)**	**9,896**	**(57,405)**

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

1. Nature of Operations and Going Concern

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.

The Company currently operates from two locations in Canada and one location in the United States. Located in Delta, British Columbia, Avcorp Industries Inc., named as Avcorp Structures & Integration ("ASI"), is dedicated to metallic and composite aerostructures assembly and integration. Within Comtek Advanced Structures Ltd. ("Comtek") located in Burlington, Ontario, exists two named divisions: Comtek, dedicated to aircraft structural component repair services, and Avcorp Engineered Composites ("AEC") dedicated to design and manufacture of composite aerostructures. Located in Gardena, California, Avcorp Composite Fabrication Inc. ("ACF") is dedicated to advanced composite aerostructures fabrication.

Avcorp Composite Fabrication Inc. is wholly owned by Avcorp US Holdings Inc. Both companies are incorporated in the State of Delaware and are wholly owned subsidiaries of Avcorp Industries Inc.

Comtek Advanced Structures Ltd., incorporated in the Province of Ontario is a wholly owned subsidiary of Avcorp Industries Inc.

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, 2017 were authorized for issue in accordance with a resolution of its Board of Directors on July 10, 2018.

During the year ended December 31, 2017, the Company incurred a net loss of $58,538,000 (December 31, 2016: $19,959,000) and had negative operating cash flows of $42,604,000 (December 31, 2016: negative $50,347,000); as at December 31, 2017, the Company had a shareholders' deficiency of $57,405,000 (December 31, 2016: $6,883,000 deficiency) and an accumulated deficit of $157,185,000 (December 31, 2016: $98,647,000). Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. Material uncertainties have been identified which may cast significant doubt upon the Company's ability to continue as a going concern. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.

The Company's ability to continue as a going concern is dependent upon its ability to continue to raise adequate financing and achieve significant improvements in operating results in the future. In assessing whether the going concern assumption was appropriate, management took into account all relevant information available about the future, which was at least, but not limited to, the 12 month period from December 31, 2017. The Company, in conjunction with its Board of Directors, is currently implementing various financing strategies which include:

- On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank. This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012. This Revolving Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at June 30, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The loan agreement matures on June 30, 2020 (note 16).
- On March 28, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendments were made:
    - Availability under the Revolving Loan is increased by USD$10,000,000 ("Expanded Loan") subject to existing drawdown provisions, interest rates and bonus fees (note 16);
    - Drawdowns under the Expanded Loan are supported by a major and material customer of the Company by way of a guarantee (note 16); and
    - The Expanded Loan matures on March 31, 2019.
- On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendment was made:
    - Maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.
- The Company ended the year with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company is able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).
- Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.
- On December 18, 2015, in conjunction with the acquisition of Hitco, the Company assumed a customer advance for pre-funded product deliveries. The customer advance is re-paid as the Company delivers to the customer. In the event that cancellation, termination, or assignment of the statement of work occurs earlier than December 31, 2018 the customer shall have the right to recover from the Company within 120 days of such an event the unamortized portion of the cash advance. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company's bank and customer.

- The customer advance was recorded at its fair value on December 18, 2015 in the amount of $18,953,000. The remaining unamortized customer advance has been discounted to arrive at the December 31, 2017 amount of $7,227,000 (December 31, 2016: $11,573,000) of which it is estimated $7,227,000 (December 31, 2016: $8,034,000) will be amortized during the next twelve months. The Company amortized into revenue $3,702,000 of the customer advance during the year ended December 31, 2017 (December 31, 2016: $6,287,000).

The Company, in conjunction with is Board of Directors continue to carry out various operational strategies which include:

- Contract renegotiations with customers and new customer contracts have provided an improved basis for operations in the future.
- Close collaboration with customers has resulted in both financial and operational support for continued operations.

The assessment of the Company's ability to execute its strategy of reducing operating costs and funding future working capital requirements involves significant judgement. Estimates and assumptions regarding future operating costs, revenue and profitability levels and general business and customer conditions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Management is actively working to secure additional production orders, extension to its banking agreements, will continue to work with existing common shareholders, and will seek additional financing as necessary. 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.

2. Basis of Preparation and Measurement

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The consolidated financial statements have been prepared on a historical cost basis. 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 subsidiaries Comtek Advanced Structures Ltd., Avcorp US Holdings Inc., and Avcorp Composite Fabrication Inc. (the "Group"). All material 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 subsidiaries as at December 31, 2017. 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. 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, income 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.

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.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value. Acquisition-related costs are expensed as incurred and included in administrative expenses.

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. The functional currency of the Company's subsidiary, Avcorp US Holdings Inc., and ACF is determined to be US dollars.
- On consolidation, the assets and liabilities of foreign operations are translated into Canadian dollars at the rate of exchange prevailing at the reporting date and their statement of income are translated at average exchange rates prevailing during the period. The exchange differences arising on translation for consolidation are recognized in other comprehensive income ("OCI"). On disposal of a foreign operation, the component of OCI relating to that particular foreign operation is reclassified to consolidated income.
- Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the spot rate of exchange at the reporting date.
- 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

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. When determining fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and also considers assumptions that market participants would use when pricing an asset or liability. The fair value hierarchy has three levels of inputs that may be used to measure fair value: Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities; Level 2—Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability; and Level 3—Unobservable inputs for the asset or liability. The Company has not applied fair value measurements to any of its financial instruments.

Financial instruments

a) Financial assets

Financial assets include, in particular, cash, accounts receivables, other assets and consideration receivable.

Financial assets are recognized at the contract date and initially measured in accordance with IAS 39, Financial Instruments: Recognition and Measurement. The measurement of financial assets subsequent to initial recognition depends on whether the financial instrument is held for trading, held-to-maturity, available-for-sale, or whether it falls in the loans and receivables category. The assignment of an asset to a measurement category is performed at the time of acquisition and is primarily determined by the purpose for which the financial asset is held.

Held for trading instruments are held at fair value. Changes in fair value are included in the consolidated statement of loss unless the instrument is included in a cash flow hedge. If the instruments are included in a cash flow hedging relationships, which are effective, changes in value are taken to equity. When the hedged forecast transaction occurs, amounts previously recorded in equity are recognized in the statement of loss. The Company has no such financial instruments.

Held-to-maturity instruments are measured at amortized cost using the effective interest method. The Company has no such financial instruments.

Available-for-sale assets are held at fair value. Changes in fair value arising from changes in exchange rates are included in the consolidated statement of loss. All other changes in fair value are taken to equity. On disposal, the accumulated changes in value recorded in equity are included in the gain or loss recorded in the statement of loss. The Company has no such financial instruments.

Loans and receivables are held at amortized cost and not revalued (except for changes in exchange rates which are included in the consolidated statement of loss). The Company's financial assets in this category are: cash, accounts receivables, consideration receivable and other assets.

At each statement of financial position date, the carrying amounts of financial assets that are not measured at fair value through profit or loss are assessed to determine whether there is any substantial objective indication of impairment. The amount of impairment loss is recognized in the statement of loss. If impairment is indicated for available-for-sale financial assets, the amounts previously recognized in equity are eliminated from other comprehensive income up to the amount of the assessed impairment loss and recognized in the consolidated statement of loss.

b) Financial liabilities

Financial liabilities often entitle the holder to return the instrument to the issuer in return for cash or another financial asset. These include, in particular, bank indebtedness, accounts payables, finance lease liabilities and term debt.

Financial liabilities are measured at their fair value at the time of acquisition, which is normally equivalent to the net loan proceeds. Transaction costs directly attributable to the acquisition are deducted from the amount of all financial liabilities that are not measured at fair value through profit or loss subsequent to initial recognition. If a financial liability is interest free or bears interest at below the market rate, it is recognized at an amount below the settlement price or nominal value. The financial liability initially recognized at fair value is amortized subsequent to initial recognition using the effective interest method.

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 loss during the period in which they are incurred.

An estimation is made of the useful life of property, plant and equipment. The useful life is measured in terms of years 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 leases up to 2028

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. The useful lives of the assets are reviewed annually and adjusted if appropriate. The amortization expense in property, plant and equipment is recognized in the consolidated statement of loss in the expense category that is consistent with the function of the property, plant and equipment.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses. Internally generated intangibles, excluding capitalized development costs, are not capitalized and the related expenditure is reflected in profit or loss in the period in which the expenditure is incurred.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the profit or loss in the expense category that is consistent with the function of the intangible assets.

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 number of shipsets management believes is a reasonable estimate of units to be sold for the program.

Segment Reporting

Management has determined the operating segments based on information regularly reviewed for the purposes of decision making, allocating resources and assessing performance by the Company's chief operating decision maker; the Chief Executive Officer (CEO). The Company evaluates the financial performance of its operating segments primarily based on operating income or loss.

Impairment of non-financial assets

The Company assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating units ("CGU") fair value less costs of disposal and its value in use. The Company's CGUs are ASI, Comtek, and ACF. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded companies or other available fair value indicators.

The Company bases its impairment calculation on detailed budgets and forecast calculations, which are prepared separately for each of the Company's CGUs to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year.

An assessment is made at each reporting date to determine whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, the Company estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

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 and unfavourable contracts liability

In connection with the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc. ("Hitco"), a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL") (note 33) the Company assumed existing long-term and short-term customer contracts. Based on our review of these contracts, the Company concluded that the terms of the contracts to be unfavourable, compared to what could be realized in market transactions, as of the date of the acquisition. As a result, the Company recognized contract liabilities, assumed, based on the present value of the difference between the contractual cash flows of the unfavorable contracts and the estimated cash flows to fulfil the obligation under the terms of the existing contracts from the acquisition date. The liabilities principally relate to long-term life of program contracts that were initially executed in the years prior to the acquisition (note 20).

The Company measured these liabilities under the measurement provisions of IFRS 13, Fair Value Measurements, which is based on the price to transfer the obligation to a market participant at the measurement date, assuming that the liabilities will remain outstanding in the marketplace. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions. The judgments used to determine the estimated fair value assigned to each long-term contracts can materially impact our results of operations.

Included in income is the non-cash amortization of acquired contract liabilities recognized as fair value adjustments through purchase accounting from the acquisition of ACF. For the year ended December 31, 2017, the Company recognized net amortization of unfavourable contract liabilities of $9,058,000 (December 31, 2016: $38,937,000). The balance of the liability as of December 31, 2017 is $44,460,000 and, is based on a units of production basis over the expected life of the contracts. The unfavorable contract liability is amortized on a units-of-production basis over the expected lives of the contracts, the longest of which at the acquisition date was expected to be December 31, 2023, however in 2016, the Company successfully renegotiated one of the major contracts attributing to the unfavorable contracts liability such that the term of the contract was reduced from December 31, 2023 to December 31, 2019.

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 of the product have passed to the customer.

The term 'bill and hold' sale is used to describe a transaction where delivery is delayed at the customer's request, but the customer takes title and accepts billing. Revenue is recognized when the customer takes title, provided it is probable that delivery will be made, the item is on hand, identified and ready for delivery to the customer at the time the sale is recognized, the customer specifically acknowledges the deferred delivery instructions, and the usual payment terms apply.

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 twelve 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 the consolidated statement of loss straight-line 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 consolidated statement of loss. 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 income tax

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

- taxable temporary differences associated with investments in subsidiaries, 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 income tax assets are recognized for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses 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.

The carrying amount of deferred income 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 income tax asset to be utilized. Unrecognized deferred income 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 income tax asset to be recovered.

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

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

Capital Stock

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

Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net loss 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 and warrants.

Leases

Leases are classified as finance or operating leases. A lease that transfers substantially all the benefits and risks incidental 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.

Accounting standards issued but not yet effective

The following is a brief summary of the new standards issued but not yet effective:

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 presents new requirements for the recognition of revenue, replacing IAS 18 "Revenue", IAS 11 "Construction Contracts", and several revenue-related Interpretations. The new standard establishes a control-based revenue recognition model and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for arrangements with multiple performance obligations, variable pricing, customer refund rights, supplier repurchase options, and other common complexities.

The Company is in the process of evaluating the impact of adopting these standards on the Company's consolidated financial statements. IFRS 15 permits either a full or modified retrospective approach for the adoption and is effective for annual periods beginning on or after January 1, 2018.

The Company has undertaken a project to assess the impact of IFRS 15 and ensure the Company's compliance with IFRS 15. The Company has collected an inventory of significant contracts with customers in scope for IFRS 15 assessment and identified preliminary accounting topics that may impact the Company's reported results based on the review of a sample of contracts from each revenue stream. The Company is in the process of reviewing contracts with customers to ensure revenue recognition practices are in accordance with IFRS 15 and evaluating potential changes to revenue processes and systems. The Company has identified contracts in which performance obligations are satisfied over time as control transfers during production. For these contracts, the revenue recognition pattern may change with revenue being recognized earlier in the year of adoption as compared to under the previous accounting policy. Contracts that do not meet the criteria for over time recognition will continue to be recognized at a point in time.

The Company continues to assess the impact of this standard on the consolidated financial statements. The Company plans to disclose the estimated financial effects of the adoption of IFRS 15 in its March 31, 2018 quarterly consolidated financial statements.

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments ("IFRS 9") 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. The Company plans to adopt the new standard on the required effective date and will not restate comparative information.

The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements. Overall, the Company expects no significant impact on its statement of financial position and equity except for the effect of applying the impairment requirements of IFRS 9.

IFRS 16 - Leases

In January 2016, the IASB issued IFRS 16 – Leases ("IFRS 16") which replaces IAS 17 – Leases and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, distinguishing between a lease and a service contract on the basis of whether the customer controls the asset being leased. For those assets determined to meet the definition of a lease, IFRS 16 introduces significant changes to the accounting by lessees, introducing a single, on-balance sheet accounting model that is similar to current finance lease accounting, with limited exceptions for short-term leases or leases of low value assets. Lessor accounting remains similar to current accounting practice. The standard is effective for annual periods beginning on or after January 1, 2019, with early application permitted for entities that apply IFRS 15. The Company plans to adopt the new standard on the required effective date. The Company has not yet assessed the impact the final standard is expected to have on its consolidated financial statements.

IFRS 2 – Share Based Payments

In 2016, the IASB issued the final amendments to IFRS 2, Share-based Payments ("IFRS 2") that clarify the classification and measurement of share-based transactions, consisting of: accounting for cash-settled share-based payment transactions that include a performance condition; classification of share-based payment transactions with net settlement features; accounting for modifications of share-based payment transactions from cash-settled to equity-settled. The amendments are effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. The amendments are to be applied prospectively. However, retrospective application is allowed if this is possible without the use of hindsight. The Company plans to adopt the new standard on the required effective date and will apply the amendments prospectively. The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements.

IFRIC Interpretation 22 – Foreign Currency Transactions and Advance Consideration

In 2016, the IASB issued IFRIC Interpretation 22, Foreign Currency Transactions and Advance Consideration ("IFRIC 22"), which provides requirements about which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. On initial application, entities have the option to apply either retrospectively or prospectively. The Company plans to adopt the new standard on the required effective date and will apply the amendments prospectively. The Company is in the process of evaluating the impact of adopting these amendments on the Company's consolidated financial statements.

4. Critical Accounting Estimates and Judgements

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and judgments that affect the amounts which are reported in the consolidated financial statements during the reporting period. Estimates and other judgments are evaluated at each reporting date and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. The critical estimates and judgements utilized in preparing the Company's consolidated financial statements affect the assessment of net recoverable amounts, net realizable values and fair values, and the determination of functional currency of the Canadian operations of the group. Any changes in estimates and assumptions could have a material impact on the assets and liabilities at the date of the statement of financial position. The Company reviews its estimates and assumptions on an ongoing basis and uses the most current information available and exercises careful judgement in making these estimates and assumptions.

- Functional currency: The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which each operates. The Company has determined that the functional currency for the Company and all its subsidiaries except for Avcorp US Holdings Inc. and ACF is the Canadian dollar. The functional currency for Avcorp US Holdings Inc. and ACF is the US dollar. The determination of functional currency may require certain judgements to determine the primary economic environment. The Company reconsiders the functional currency used when there is a change in events and conditions which determined the primary economic environment.

- Impairments: The recoverable amount of intangible assets, development costs and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each CGU or group of CGUs. In order to estimate the fair value of indefinite-lived intangible assets and goodwill resulting from business combinations, the Company typically estimates future revenue, considers market factors and estimates future cash flows. Based on these key assumptions, judgments and estimates, the Company determines whether to record an impairment charge to reduce the value of the asset carried on the consolidated statement of financial position to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Company's business strategy or internal forecasts. Although the Company believes the assumptions, judgments and estimates made in the past have been reasonable and appropriate, different assumptions, judgments and estimates could materially affect the Company's reported financial results.

- Going concern: 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.

- Capitalization of development costs: When capitalizing development costs the Company must assess the technical and commercial feasibility of the projects and estimate the useful lives of resulting products. Determining whether future economic benefits will flow from the assets and therefore the estimates and assumptions associated with these calculations are instrumental in (i) deciding whether project costs can be capitalized, and (ii) accurately calculating the useful life of the projects for the Company.

- Unfavorable contracts liability: At the acquisition date valued the unfavorable contracts liability at fair value using certain assumptions that would arise in a market participant view. The Company estimates the expected shipsets or production when assessing the liability, together with the discounts rate and period of performance under the varying contracts and service agreements. The cash flows are discounted over the period of performance using a discount rate commensurate with the risk associated with the liability.

- Fair value of assets and liabilities acquired in a business combination: The Company accounted for the acquisition of ACF using the acquisition method when control is transferred to the Company. The consideration received is generally measured at fair value, as are the identifiable net liabilities assumed. The fair value of the liabilities assumed is determined using valuation techniques that require estimation of the estimated cash flows, discount rates and estimated operating margins.

- Inventories are valued at the lower of cost and net realizable value. The costs of inventory involve estimates in determining the allocation of fixed and variable production overhead. These estimates involved include determination of normal production capacity and nature of expenses to be allocated. Additionally inventory is reviewed monthly to ensure the carrying value does not exceed net realizable value. If so, a write-down is recognized. The write-down may be reversed if the circumstances which caused it no longer exist.

- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $4,309,000 of overhead costs during the current year (December 31, 2016: $4,408,000) in respect of unutilized plant capacity. These amounts are included in the Consolidated Statements of Loss and Comprehensive Loss as costs of sales.

- The Company has entered into production contracts in the ordinary course of its business. The unavoidable cost of meeting the obligations under certain of these contracts exceeds the associated expected future net benefits; consequently, an onerous contract provision has been recognized. The calculation of this provision involves the use of estimates including, but not limited to, program gross margin, and the effect of learning curves of production and the timing of achieving certain operational efficiencies. These actual results can vary significantly from these estimates with consequent variability in the amounts of the provision recorded. The onerous contract provision is calculated by taking the expected future costs that will be incurred under the contract and deducting any estimated revenues. A portion of the onerous contract provision is for costs incurred that were greater than the expected future costs used to determine the fair value of the unfavourable contract liability; this portion of the onerous contract provision for the year ended December 31, 2017 is $3,479,000. The remaining portion of the onerous contract provision is primarily due to a high cost structure and learning curves of production that cannot be recovered through current pricing of the associated contracts. The current portion of the onerous contract provision for the year ended December 31, 2017 is $7,297,000. The onerous contract provision for the year ended December 31, 2017 is $13,366,000 (December 31, 2016: $37,000).

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

5. Expenses by Nature

The Consolidated Statements of Loss and Comprehensive Loss presents expenses by function. Accordingly, amortization and depreciation is not 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 associated with manufacturing facility.

Expenses by nature:

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Raw materials, purchased parts and consumables	**$78,961**	$68,084
Salary, wages and benefits	**70,891**	77,010
Change in onerous contracts provision	**13,603**	-
Contracted services and consulting	**6,266**	19,431
Other expenses and conversion of costs into inventory	**4,909**	2,768
Plant equipment rental and maintenance	**4,333**	5,950
Depreciation	**4,153**	3,915
Rent	**3,695**	4,332
Utilities	**3,143**	5,848
Legal and audit fees	**2,981**	1,484
Transportation	**2,240**	2,992
Amortization of development costs	**1,924**	604
Travel costs	**1,488**	1,728
Amortization of intangible assets	**1,299**	1,325
Office equipment rental/maintenance	**1,071**	2,130
Bad debt expense	**1,030**	1,328
Insurance	**623**	659
Office supplies	**384**	278
Royalties	**223**	246
	203,217	200,112

6. Capital Risk Management

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

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

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

The Company's loan agreement with a Canadian chartered bank restricts the declaration or payment of any dividend.

7. Financial Risk Management

The Company is exposed to certain financial risks including market risk, currency risk, credit risk, liquidity risk, interest rate risk and price risk. The note presents information about the Company's risk to each of these risks; its objectives, policies and processes for measuring and managing risk.

a) Market Risk

Market risk is the risk that changes in the market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holdings of financial instruments. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes. The Company may utilize derivative instruments in the management of its foreign currency and interest rate exposures.

b) Currency Risk

Currency risk arises because the amount of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rate ("transaction exposures") and because the non-Canadian dollar denominated financial statements of the Company's subsidiaries may vary on consolidation into the reporting currency of Canadian dollars ("translation exposures").

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

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 and components in US dollars at prices that are usually established at the order date. The Company's operations are based in Canada and in the US. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange loss recorded for the year ended December 31, 2017 is $1,944,000 (December 31, 2016: $3,278,000 loss).

The Company had the following US dollar denominated balances:

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Bank cash position	**US$2,929**	US$1,205
Accounts receivable	**9,749**	15,278
Consideration receivable	**-**	9,124
Accounts payable net of prepayments	**2,111**	1,574
Bank indebtedness	**48,851**	4,250
Term debt	**868**	4,560

With other variables unchanged, each $0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately $3,915,000 in net income for the year ended December 31, 2017 as a result of holding a net liability position in USD as at December 31, 2017.

As at December 31, 2016, a $0.10 strengthening (weakening) of the CAD against the USD would result in a (decrease) increase of approximately $1,522,000 in net income for the year ended December 31, 2016 as a result of holding a net USD asset position in as at December 31, 2016.

c) 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"), BAE Systems (Operations) Limited ("BAE"), Lockheed Martin ("LM"), and Subaru Corporation ("Subaru"). 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 86.6% (December 31, 2016: 69.8%) of the Company's trade accounts receivable are attributable to these customers.

The Company is exposed to credit risk if counterparties to its trade receivables are unable to meet their obligations. The concentration of credit risk from its customers is minimized because the Company has an original equipment manufacturer and tier one aerospace customer base as at December 31, 2017. The customers are predominately large, well-capitalized, and long established entities with a low risk of non-payment. The Company regularly monitors its credit risk and credit exposure.

The following table provides the change in allowance for doubtful accounts for trade receivables:

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Balance as at January 1	**$326**	$137
Additions	**1,168**	1,517
Use	**(129)**	(1,328)
Collection	**(128)**	-
Balance as at December 31	**1,237**	326

The following table provides aged trade receivables:

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Current	**$8,587**	$13,954
31 – 60 days	**5,895**	2,953
61 – 90 days	**1,841**	3,077
Over 90 days	**379**	4,221
Total	**16,702**	24,205

Consideration receivable arising from a 2015 business acquisition (notes 33) is guaranteed by the seller and a Canadian chartered bank.

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

d) 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 16). Term debt repayments are as outlined in note 22.

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.

Subsequent to year end, the Company entered into agreements to expand its loan facilities (note 34).

				December 31, 2017
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness (note 16)	$61,283	$-	$-	$-
Term debt (note 22)	1,136	149	1,883	2
Trade payables (note 18)	17,263	-	-	-
Payroll related liabilities (note 18)	5,150	-	-	-
Accrued interest (note 18)	-	-	839	-
Restoration provision (note 18)	-	-	-	446
Restructuring provision (note 18)	-	103	-	-
Other accruals (note 18)	-	33	-	-

				December 31, 2016
	Less than 3 months	**3 months to 1 year**	**2 – 5 years**	**Over 5 years**
Bank indebtedness (note 16)	$17,111	$-	$-	$-
Term debt (note 22)	39	6,942	454	1,192
Trade payables (note 18)	24,835	-	-	-
Payroll related liabilities (note 18)	5,793	-	-	-
Accrued interest (note 18)	-	-	35	-
Restoration provision (note 18)	-	-	-	247
Restructuring provision (note 18)	-	371	-	-
Other accruals (note 18)	-	841	-	-

e) Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit.

Interest rate for advances made up to the maximum of the allowable borrowing base on the existing USD$23,000,000 revolving loan:

- RBP plus 0.75% per annum
- RBUSBR plus 0.75% per annum
- BA Equivalent Rate plus 2.25% per annum
- LIBOR Rate plus 2.25% per annum

Interest rate for advances made on the additional borrowing capacity up to USD$58,000,000.

- RBP plus 0.00% per annum
- RBUSBR plus 0.00% per annum
- BA Equivalent Rate plus 0.875% per annum
- LIBOR Rate plus 0.875% per annum

Drawdown under the USD$35,000,000 additional borrowing capacity is supported by a major and material customer of the Company by way of a guarantee.

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

The Company will provide the guarantor, as consideration for the guarantee, a fee equal to 5.375% of the weighted average outstanding balance of the guaranteed portion over each full twelve (12) month period commencing on the funding date plus, for the partial year thereafter, 5.375% of the weighted average outstanding balance of the guaranteed portion multiplied by the number of days in the partial year divided by three hundred sixty (360). The fee will be payable on the maturity date

The maximum operating line of credit availability is $72,761,000 (USD$58,000,000) of which $61,283,000 is utilized as at December 31, 2017 (December 31, 2016: $17,111,000). The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the year ended December 31, 2017, with other variables unchanged, a 1% change in the base borrowing rate would have a $613,000 (December 31, 2016: $171,000) impact on net earnings and cash flow. Based on net collateral provided to its bank, the Company is able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

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

f) 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, 2017, the Company has $8,992,000 (December 31, 2016: $4,303,000) of firmly committed orders that include price adjustment clauses of this nature. $1,000 has been recorded as a derivative gain for the year ended December 31, 2017 as compared to a $1,000 loss for the year ended December 31, 2016 as restated as a result of the change in the fair value of the underlying embedded derivatives.

Included in prepayments and other assets is $1,000 of inflation derivatives assets arising from the Company's sales contracts having price adjustment clauses within their terms (December 31, 2016: $1,000).

g) Financial Assets and Liabilities by Category

Categories of financial instruments

Under IFRS, financial instruments are classified into one of the following categories: financial assets at fair value through profit or loss, loans and receivables, available-for-sale financial assets, financial assets and liabilities held for trading, financial liabilities at fair value through profit or loss, and other financial liabilities at amortized cost.

All financial instruments, including derivatives, are included on the consolidated statement of financial position, which are measured at fair value except for loans and receivables and other financial liabilities, which are measured at amortized costs. Held for trading investments are subsequently measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are subsequently measured at fair value with revaluation gains and losses included in other comprehensive income until the instruments are derecognized or impaired.

As at December 31, 2017 and 2016, the Company's financial assets and liabilities are categorized as follows:

				December 31, 2017
	Loans and receivables	**Total financial assets**	**Other financial liabilities (at amortized costs)**	**Total**
Financial Assets				
Cash	$5,212	$-	$-	$5,212
Accounts receivable	18,942	-	-	18,942
Inflation derivative	-	1	-	1
Financial Liabilities				
Bank indebtedness	61,283	-	-	61,283
Accounts payable	-	-	23,834	23,834
Term debt	-	-	3,170	3,170

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

				December 31, 2016
	Loans and receivables	Total financial assets	Other financial liabilities (at amortized costs)	Total
Financial Assets				
Cash	$3,960	$-	$-	$3,960
Accounts receivable	26,262	-	-	26,262
Consideration receivable	12,251	-	-	12,251
Inflation derivative	-	1	-	1
Financial Liabilities				
Bank indebtedness	17,111	-	-	17,111
Accounts payable	-	-	32,122	32,122
Term debt	-	-	7,929	7,929

8. Fair Value Measurement

At December 31, 2017 and December 31, 2016, the fair values of cash, accounts receivable, other assets, consideration receivable, accounts payable, and bank indebtedness approximated their carrying values because of the short-term nature of these instruments.

FOR THE YEAR ENDED DECEMBER 31	2017		2016	
	Carrying value	Fair value	Carrying value	Fair value
Financial liabilities				
Term debt (level 2)	**$3,170**	**$3,170**	$7,929	$7,929

Fair value hierarchy

The Company's financial assets and liabilities recorded at fair value on the consolidated statements of financial position have been categorized into three categories based on a fair value hierarchy. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than the quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data.

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The Company does not have any financial assets or financial liabilities carried at fair value as at December 31, 2017.

9. Accounts Receivable

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Trade receivables	**$16,702**	$24,205
Input tax credits	**2,176**	1,887
Accrued receivables	**64**	170
	18,942	26,262

The average trade receivables days outstanding is 54 days as at December 31, 2017 (December 31, 2016: 59 days).

The carrying amount of accounts receivable pledged as security under the Company's operating line of credit (note 16) as at December 31, 2017 is $16,702,000 (December 31, 2016: $23,325,000).

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

FOR THE YEAR ENDED DECEMBER 31	2017	2016
US dollar	**US$10,649**	US$16,592
Canadian dollar	**5,600**	3,986

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

10. Consideration Receivable

On December 18, 2015, in conjunction with the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc., a subsidiary of Frankfurt-listed SGL Carbon SE ("Hitco") (note 33), Avcorp received $32,826,000 (USD$23,540,000) in cash consideration with $12,251,000 (USD$9,220,000 undiscounted) consideration receivable remaining as at December 31, 2016. On April 3, 2017, Avcorp received the USD$9,220,000 remaining consideration receivable; USD$6,511,000 of the consideration payment was utilized to repay a portion of the debt facility with a Canadian Chartered bank (note 16). A further amount of USD$907,000 was utilized to repay a loan with Panta (note 22).

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening balance	**$12,251**	$38,720
Receipts	**(12,378)**	(26,296)
Accretion	**127**	510
Foreign exchange	**-**	(683)
	-	12,251

11. Inventories

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Raw materials	**$24,762**	$21,121
Work-in-progress	**22,156**	25,733
Finished products	**2,238**	4,495
Inventory obsolescence	**(6,375)**	(7,053)
	42,781	44,296

The amount of inventory expensed in cost of sales during the year ended December 31, 2017 amounted to $162,200,000 (December 31, 2016: $168,062,000). The carrying value of inventory pledged as security under the Company's operating line of credit (note 16) as at December 31, 2017 is $42,781,000 (December 31, 2016: $20,828,000).

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.

12. Prepayments and Other Assets

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Deposits on material purchases	**$1,126**	$461
Prepaid insurance	**1,763**	1,608
Prepaid IT security maintenance and licenses	**625**	1,029
Prepaid property tax	**425**	405
Prepaid other	**451**	641
	4,390	4,144

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

13. Development Costs

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

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening balance	**$5,200**	$3,187
Additions	**5,347**	2,617
Amortization	**(1,924)**	(604)
	8,623	5,200

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Cost	**$16,528**	$11,180
Accumulated amortization	**(7,905)**	(5,980)
Net book amount	**8,623**	5,200

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

14. Property, Plant and Equipment

	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
Year ended December 31, 2016				
Opening net book amount	28,048	1,066	526	29,640
Additions	5,827	386	623	6,836
Disposals – cost	(86)	(43)	-	(129)
Disposals – accumulated depreciation	76	8	-	84
Depreciation charge	(3,259)	(460)	(196)	(3,915)
Currency translation adjustment	(582)	(4)	-	(586)
Closing net book amount	30,024	953	953	31,930
At December 31, 2016				
Cost	57,180	8,065	1,975	67,220
Accumulated depreciation	(27,156)	(7,112)	(1,022)	(35,290)
Net book amount	30,024	953	953	31,930
Year ended December 31, 2017				
Opening net book amount	30,024	953	953	31,930
Additions	967	1,315	772	3,054
Disposals – cost	(39)	-	-	(39)
Disposals – accumulated depreciation	4	-	-	4
Depreciation charge	(3,611)	(183)	(359)	(4,153)
Currency translation adjustment	(1,380)	(57)	(41)	(1,478)
Closing net book amount	25,965	2,028	1,325	29,318
At December 31, 2017				
Cost	56,395	9,314	2,690	68,399
Accumulated depreciation	(30,430)	(7,286)	(1,365)	(39,081)
Net book amount	25,965	2,028	1,325	29,318

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

The Company has $1,012,000 in commitments at December 31, 2017 (December 31, 2016: $67,000) to purchase property, plant and equipment in 2018.

Included in computer hardware and software are assets held under finance leases at a cost of $24,000 (December 31, 2016: $24,000) having accumulated depreciation of $14,000 (December 31, 2016: $10,000).

Included in machinery and equipment are assets held under finance leases at a cost of $416,000 (December 31, 2016: $237,000) having accumulated depreciation of $66,000 (December 31, 2016: $38,000).

The Lessor of the Industrial Centre at Gardena California, where Avcorp Composite Fabrication Inc. has its manufacturing facilities, received an Offer from a third party to purchase the Industrial Centre. On March 28, 2017 Avcorp exercised its right of first refusal under the lease agreement by providing notice to the Lessor that it proposes to purchase the property on the same terms and conditions as presented in the Offer. Avcorp has up to 270 days from the date of providing such notice to present and close a sale transaction with the Lessor. In addition, Avcorp entered into a Memorandum of Understanding and a Letter Agreement with Stockdale Acquisitions LLC to negotiate a joint venture agreement for the ultimate acquisition and development of the property in exchange for a long term lease by Avcorp of a portion of the property on favourable economic terms. The negotiation of that joint venture agreement is ongoing as due diligence on the property proceeds. On June 26, 2017, Avcorp provided notice to the Lessor of the Industrial Centre at Gardena California that it has elected not to proceed with the acquisition of the property.

15. Intangibles

	Lease	Customer contract – re-compete	Developed Software	Total
Year ended December 31, 2016				
Opening net book amount	$748	$5,674	$-	$6,422
Amortization charge	(239)	(1,086)	-	(1,325)
Currency translation adjustment	(26)	(184)	-	(210)
Closing net book amount	483	4,404	-	4,887
At December 31, 2016				
Cost	725	5,505	-	6,230
Accumulated depreciation	(242)	(1,101)	-	(1,343)
Net book amount	483	4,404	-	4,887
Year ended December 31, 2017				
Opening net book amount	483	4,404	-	4,887
Additions	-	-	571	571
Amortization charge	(234)	(1,065)	-	(1,299)
Currency translation adjustment	(24)	(253)	(18)	(295)
Closing net book amount	225	3,086	553	3,864
At December 31, 2017				
Cost	677	5,143	553	6,373
Accumulated amortization	(452)	(2,057)	-	(2,509)
Net book amount	225	3,086	553	3,864

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

16. Bank Indebtedness

On September 27, 2012 the Company entered into a loan agreement with a Canadian chartered bank for a $12,000,000 principal amount secured debt facility. On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank. This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012. This revolving loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at June 30, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The loan agreement matures on June 30, 2020 (note 34).

Interest rate for advances made up to the maximum of the allowable borrowing base on the existing USD$23,000,000 revolving loan:

- RBP plus 0.75% per annum
- RBUSBR plus 0.75% per annum
- BA Equivalent Rate plus 2.25% per annum
- LIBOR Rate plus 2.25% per annum

Interest rate for advances made on the additional borrowing capacity up to USD$58,000,000.

- RBP plus 0.00% per annum
- RBUSBR plus 0.00% per annum
- BA Equivalent Rate plus 0.875% per annum
- LIBOR Rate plus 0.875% per annum

Drawdown under the USD$35,000,000 additional borrowing capacity is supported by a major and material customer of the Company by way of a guarantee.

The Company will provide the guarantor, as consideration for the guarantee, a fee equal to 5.375% of the weighted average outstanding balance of the guaranteed portion over each full twelve (12) month period commencing on the funding date plus, for the partial year thereafter, 5.375% of the weighted average outstanding balance of the guaranteed portion multiplied by the number of days in the partial year divided by three hundred sixty (360). The fee will be payable on the maturity date.

The loan agreement is subject to the existing security agreements with a Canadian Chartered bank and with its guarantor. This debt facility is secured by a charge and specific registration over all of the assets of the Company.

Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation.

The Company ended the year with bank operating line utilization of $61,283,000 offset by $5,212,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company is able to draw up to an additional USD$9,149,000 on its operating line of credit as at December 31, 2017 (December 31, 2016: $4,901,000).

FOR THE YEAR ENDED DECEMBER 31	2017
Opening balance	**$17,111**
Add: Drawdowns on bank indebtedness	**102,045**
Less: Repayment of loans	**(55,173)**
Less: Foreign exchange gain	**(2,700)**
Ending balance	**61,283**

17. Customer advance

On December 18, 2015, in conjunction with the acquisition of Hitco, the Company assumed a customer advance for pre-funded product deliveries. The customer advance is re-paid as the Company delivers to the customer. In the event that cancellation, termination, or assignment of the statement of work occurs earlier than December 31, 2018 the Customer shall have the right to recover from the Company within 120 days of such an event the unamortized portion of the cash advance. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company’s bank and a customer.

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

The Customer advance was recorded at its fair value on December 18, 2015 in the amount of $18,953,000. The remaining unamortized customer advance has been discounted to arrive at the December 31, 2017 amount of $7,227,000 (December 31, 2016: $11,573,000) of which it is estimated $7,227,000 (December 31, 2016: $8,034,000) will be amortized during the next twelve months. The Company amortized into revenue $3,702,000 of the customer advance during the year ended December 31, 2017 (December 31, 2016: $6,287,000).

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening balance	**$11,573**	$18,528
Amortization	**(3,702)**	(6,287)
Foreign exchange	**(644)**	(668)
	7,227	11,573
Less: Current portion	**7,227**	8,034
Non-current portion	**-**	3,539

18. Accounts Payable and Accrued Liabilities

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Trade payables	**$17,263**	$24,835
Payroll-related liabilities	**5,150**	5,793
Accrued interest	**839**	35
Restoration provision	**446**	247
Restructuring provision	**103**	371
Other	**33**	841
	23,834	32,122

19. Deferred Program Revenues

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening balance	**$13,972**	$4,924
Additions	**10,502**	15,043
Realized	**(7,233)**	(5,995)
	17,241	13,972
Less: Current portion	**17,131**	13,861
Non-current portion	**110**	111

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, on a units-of-production basis over the expected life of the programs, in conjunction with the associated deferred revenue upon commencement of production.

20. Unfavourable Contracts Liability

On December 18, 2015, in conjunction with the acquisition of Hitco, the Company assumed an unfavourable contract liability on certain long term revenue contracts for which unavoidable costs are expected to exceed the corresponding revenues earned. The unfavourable contracts liability is amortized into income on a units-of-production basis over the expected life of the contracts which are contracted up to December 31, 2019.

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

As at December 31, 2017, the remaining unamortized unfavourable contracts liability amounted to $44,460,000 (December 31, 2016: $56,969,000).

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening net book amount	**$56,969**	$99,471
Amortization and contract renegotiation	**(9,058)**	(38,937)
Foreign exchange	**(3,451)**	(3,565)
Closing net book amount	**44,460**	56,969
Less: Current portion	**16,881**	18,904
Non-current portion	**27,579**	38,065

The result of the renegotiation of certain contract delivery requirements in 2016 resulted in a reduction of future delivery commitments. Management performed a cumulative catch-up revenue adjustment of $7,249,000 in 2016 further reducing the provision as at December 31, 2016. The remaining provision is to be amortized over the reduced contractual life of the contract. The effect of this adjustment is to adjust the per unit amortization charge of finished goods already shipped to reflect the updated amortization charge per unit had the amended agreement existed as at the commencement date of the contract.

21. Deferred Gain and Lease Inducement

On July 17, 2003, the Company sold its land and building in Delta 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 $26,000 as at December 31, 2017 (December 31, 2016: $73,000).

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 $74,000 as at December 31, 2017 (December 31, 2016: $173,000).

22. Term Debt

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Finance leases (a)	**$218**	$147
Term loans (b) (c) (d)	**1,237**	6,384
SADI (e)	**1,715**	1,398
	3,170	7,929
Less: Current portion	**1,285**	6,283
Non-current portion	**1,885**	1,646

a) Finance Leases

There are various equipment leases that have a weighted average interest rate of 8.01% per annum (2016: 7.60%). 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) Term Loan

On September 19, 2016, Avcorp entered into a non-revolving term loan agreement ("loan") with Panta Canada B.V. ("Panta") to fund the Company to a maximum aggregate principal amount of USD$5,000,000 due on April 7, 2017. The Company received its first advance on September 23, 2016 of USD$2,000,000 ($2,612,000). On October 25, 2016, Panta provided a second advance in the amount of USD$1,500,000 ($1,983,000) and a third advance on November 15, 2016 in the amount of USD$1,500,000 ($2,020,000).

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 68.6% of the issued and outstanding common shares on December 31, 2017. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

The Company's acceptance of this loan was subject to a 3% commitment fee (USD$150,000) paid by the Company to Panta Canada B.V. from proceeds of the first advance.

In conjunction with receiving advances under the term loan, the Company issued Panta 30,714,118 common share purchase warrants ("warrants") on a pro-rata basis, each warrant is exercisable for a period of 24 months following the date of issuance with respect to one common share at an exercise price of $0.07 per common share. The Company issued 12,285,647 such warrants on September 19, 2016, 9,214,235 such warrants on October 24, 2016, and 9,214,236 such warrants on November 10, 2016. The warrants were valued at fair value on date of issue using the Black Scholes option pricing model.

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

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Opening balance	**$6,123**	$6,617
Accrued interest	**348**	87
Less: Fair value of warrants issued	**-**	(1,164)
Less: Repayment	**(3,478)**	-
Less: Exercise of warrants	**(2,118)**	-
Add: Foreign exchange gain	**(500)**	42
Accretion	**715**	541
	1,088	6,123

The loan bears interest at 8% per year, is subordinated to existing security agreements and could be prepaid without interest and penalties. The interest rate will increase to 15% per year, and all outstanding indebtedness including unpaid interest, will continue to accrue such interest, after the loan maturity date until paid in full. The loan and all accrued interest was due and payable on April 7, 2017.

As at that date the Company and Panta amended the term loan to provide for a maturity date which is the earlier of the date on which credit is available to be drawn by the Company under the revolving loan with a Canadian Chartered bank, and July 6, 2017, with interest continuing at 8% per year. The Company incurred a USD$100,000 amendment fee in this regard.

Effective July 6, 2017 the Company and Panta amended the term loan to provide for a maturity date which is the earlier of (i) the date upon which, for any reason, the outstanding principal balance of the revolving loan with a Canadian Chartered bank becomes due and owing and (ii) the date on which all or substantially all the assets of Comtek are sold by the Borrower or a controlling interest in the shares of Comtek is sold by the Borrower in each case by a transaction or series of transactions, and (iii) July 6, 2021.

As at July 7, 2017 the loan bears interest at the aggregate rate of interest, expressed as an annual rate, of the U.S. Base Rate of Royal Bank of Canada (RBUSBR) plus a margin of 5.375% per annum which shall accrue and not be compounded until the maturity date.

On July 31, 2017 the Company repaid a principal amount of USD$2,500,000 plus interest accrued in the amount of USD$285, 000 of the Panta term loan.

On August 3, 2017 Panta exercised 12,105,327 warrants expiring August 17, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation (note 24).

On August 25, 2017 Panta exercised 6,052,664 warrants expiring September 9, 2017 at $0.07 whose aggregate price of $424,000 was deemed to be made by way of set-off against the Panta loan obligation (note 24).

On September 8, 2017 Panta exercised 12,105,327 warrants expiring September 23, 2017 at $0.07 whose aggregate price of $847,000 was deemed to be made by way of set-off against the Panta loan obligation (note 24).

Pursuant to the terms of the loan agreement, the Company is required to meet certain covenants. The Company is in breach of certain covenants pursuant to the terms of the loan agreement and accordingly an event of default had occurred that requires remediation. The entire loan balance has been classified as current portion of term debt.

c) Term Loan

On March 17, 2017, Avcorp entered into a loan agreement ("Loan") with Panta Canada B.V. ("Panta") bearing interest of 8% per annum to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The Loan was repaid on April 3, 2017 from the proceeds of the consideration receivable. Panta Canada B.V. is Avcorp's majority shareholder owning approximately 68.6% of the issued and outstanding common shares on December 31, 2016. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

d) Term Loan

On March 13, 2015, the Company completed a secured term loan with a principal amount of $450,000. The Company received full funding from the loan on March 26, 2015. The purpose of the loan was to finance machinery and equipment required for new production programs at its Burlington ON facility.

The term loan has been provided by a Canadian chartered bank. The loan has a four year term; it is secured by a general security agreement constituting a first ranking security interest in all personal property of the Company and a first ranking and specific interest in the equipment financed. Export Development Canada ("EDC") has guaranteed 50% of the aggregate borrowings outstanding under the loan. The fee associated to the guarantee provided by EDC is equal to 3% of 50% of the outstanding loan amount. Interest is calculated and paid monthly at a rate of bank prime plus 1%. The loan will be repaid over 48 months by way of blended principal and interest payments. The balance outstanding for this term loan as at December 31, 2017 is $149,000 (December 31, 2016: $261,000).

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

e) 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.

$1,715,000 was drawn on this facility as at December 31, 2017 (December 31, 2016: $1,398,000). The amounts owing, when due, are repayable to the Industrial Technologies Office.

FOR THE YEAR ENDED DECEMBER 31	2017
Opening balance	**$1,398**
Add: Accrued interest	**57**
Add: Contributions	**260**
Ending balance	**1,715**

23. Obligations and Commitments Under Finance and Operating Leases, and Contingent Liabilities

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	2017		2016	
	Operating	**Finance**	Operating	Finance
2017	**$-**	**$-**	$2,892	$56
2018	**4,416**	**94**	3,246	56
2019	**2,500**	**84**	479	46
2020	**2,301**	**44**	255	7
2021	**2,164**	**25**	130	-
2022	**2,287**	**-**	-	-
Thereafter	**13,571**	**-**	-	-
Total future minimum lease payments	**27,239**	**246**	7,002	165
Less: Imputed interest	**n/a**	**(28)**	n/a	(18)
Balance of obligation under finance leases included in term debt (note 22)	**n/a**	**218**	n/a	147

For the year ended December 31, 2017, an amount of $2,865,000 representing payments under operating leases was expensed (December 31, 2016: $2,897,000).

As at December 31, 2017 the Company had $38,811,000 of committed contractual operational purchase order obligations outstanding (December 31, 2016: $38,963,000).

Two of the Company’s customers have made certain claims against the Company; one in the amount of €2,864,000 which represents a claim against the Company for untimely delivery of product to that customer; the second claim in the amount of $700,000USD which represents a claim for certain services performed by the second customer on behalf of the Company. The Company has a claim, in excess of the amounts claimed, against one of the customers. The Company and its two customers are currently negotiating a three-way settlement and the outcome of those negotiations are currently undeterminable.

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

24. Capital Stock

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, 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 337,404,502 common shares issued at December 31, 2017. The book value of common shares issued and outstanding as at December 31, 2017 was $82,905,000 (December 31, 2016: $80,302,000).

Common shares issued or reserved:

	Number of shares	Amount
December 31, 2015	305,555,184	80,158
Share issue		
Cash (b)	1,586,000	113
Transfer from contributed surplus on exercise of stock options (b)	-	31
December 31, 2016	307,141,184	80,302
Share issue		
Non-cash (a)	30,263,318	2,118
Transfer from contributed surplus on exercise of stock warrants (a)	-	485
December 31, 2017	337,404,502	82,905

a) During the third quarter 2017 holders of the Company's warrants exercised 30,263,318 warrants at a price of $0.07 resulting in the issuance of 30,263,318 common shares with a value of $2,118,000.

b) During the second quarter 2016 holders of the Company's stock options exercised 960,500 stock options at a price of $0.085 and 625,500 stock options at a price of $0.05 resulting in the issuance of 1,586,000 common shares with a value of $113,000.

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

A summary of the Company's stock options issued as of December 31, 2017 and December 31, 2016, and changes during the periods ending on those dates, are presented below.

FOR THE YEAR ENDED DECEMBER 31	**2017**		2016	
	Options	**Weighted average exercise price**	Options	Weighted average exercise price
Outstanding – Beginning of year	**52,225,500**	**0.092**	34,653,500	$0.09
Granted	**-**	**-**	29,370,500	0.089
Expired	**-**	**-**	(1,250,000)	0.05
Exercised	**-**	**-**	(1,586,000)	0.071
Forfeited	**(2,693,000)**	**0.095**	(8,962,500)	0.158
Outstanding – End of year	**49,532,500**	**0.092**	52,225,500	0.092

The following table summarizes stock options which are exercisable as at December 31, 2017:

	Number	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**
$0.085 - $0.100	29,847,250	6.08	$0.093

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

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

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Beginning of year	**$6,744**	$4,453
Stock-based compensation expense	**718**	1,158
Fair value of warrants issued	**-**	1,164
Cancellation of issued stock options	**2**	-
Transfer to share capital on exercise of stock options	**-**	(31)
Transfer to share capital on exercise of warrants	**(485)**	-
End of year	**6,979**	6,744

The stock-based compensation expense is included in the Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amounts to $718,000 (December 31, 2016: $1,158,000).

In conjunction with receiving advances under a term loan (note 22), the Company issued Panta 30,714,118 common share purchase warrants ("warrants") on a pro-rata basis, each warrant is exercisable for a period of 24 months following the date of issuance with respect to one common share at an exercise price of $0.07 per common share. The Company issued 12,285,647 such warrants on September 19, 2016, 9,214,235 such warrants on October 24, 2016, and 9,214,236 such warrants on November 10, 2016.

e) A summary of the Company's warrants issued as of December 31, 2017 and December 31, 2016, and changes during the periods ending on those dates, are presented below.

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Outstanding – Beginning of year	**60,977,436**	30,263,318
Granted (i)	**-**	30,714,118
Expired	**-**	-
Exercised	**(30,263,318)**	-
Outstanding – End of year	**30,714,118**	60,977,436

i. September 19, 2016: Grant of 12,285,647 Warrants expiring September 19, 2018 at $0.07 to Panta.

October 24, 2016: Grant of 9,214,235 Warrants expiring October 24, 2018 at $0.07 to Panta.

November 10, 2016: Grant of 9,214,236 Warrants expiring November 10, 2018 at $0.07 to Panta.

ii. August 3, 2017: Exercise of 12,105,327 Warrants expiring August 17, 2017 at $0.07 to Panta.

August 25, 2017: Exercise of 6,052,664 Warrants expiring September 9, 2017 at $0.07 to Panta.

September 8, 2017: Exercise of 12,105,327 Warrants expiring September 27, 2017 at $0.07 to Panta.

25. Stock Based Compensation

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

No stock options were granted in the year ended December 31, 2017.

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

	2016
Number of options	29,370,500 Options
Risk-free rate (%)	1.35
Dividend yield (%)	-
Expected Lives (years)	5
Volatility (%)	57.70

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

The amount of stock-based compensation expense, for options granted in current and prior periods, amortized to earnings during the year ended December 31, 2017 was $718,000 (2016: $1,158,000). Stock-based compensation expense has been included in the Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses.

During the year ended, 2,693,000 stock options were forfeited.

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.

26. 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	2017	2016
Defined contribution plan	**$1,341**	$1,280

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 and Comprehensive Loss as administrative and general expenses and cost of sales.

27. Finance Costs

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Interest on finance leases	**$12**	$14
Interest on other term debt	**173**	63
Interest on bank indebtedness	**1,711**	158
Interest on related party debt	**335**	87
Non-cash financing cost accretion	**589**	31
Interest expense	**2,820**	353
Interest income	**(14)**	(14)
Net interest expense	**2,806**	339

28. Supplementary Cash Flow Information

Non-cash financing and investing activities:

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Equipment acquired under capital lease	**$125**	$-
Equipment acquired through accounts payable	**-**	1,707
Accounts payable settled with consideration receivable	**-**	3,867
Panta loan settled with exercise of warrants	**2,118**	-
Restoration provision revaluation	**185**	-
Transfer to share capital on exercise of warrants	**485**	-

29. Income Tax

The provision for income tax (recovery) expense is based on the combined Canadian federal and provincial annual income tax rate expected for the full financial year of 26%.

On December 22, 2017, the U.S. enacted the Tax Cuts and Job Act (TCJA). Substantially all the provisions of the TCJA are effective for taxable years beginning after December 31, 2017. The most significant provisions of Tax Reform that impact the Company is the reduction in the federal corporate tax rate from 35% to 21%.

IAS 12, Income Taxes, states that the tax effects of changes in tax laws must be recognized in the period in which the law is enacted or substantively enacted. IAS 12 further requires deferred income tax assets and liabilities to be measured at the enacted or substantively enacted tax rate expected to apply when temporary differences are to be realized or settled. Thus, at the date of enactment, the Company's deferred income taxes were re-measured based upon the new tax rate. The change in deferred income taxes is generally recorded as a non-cash re-measurement adjustment to earnings.

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

The Company has made a reasonable estimate for the measurement of certain effects of the TCJA. However, the Company is taking a full valuation allowance. Therefore, considered in net, no deferred tax assets/liabilities were booked. As the Company has not recognized any deferred amounts, historically or currently, the TCJA has no tax impact on the Company as of December 31, 2017.

Deferred income 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 $35,727,000 (2016: $26,399,000) in respect of losses amounting to $107,532,000 (2016: $74,783,000) which include foreign losses of $29,260,000 (2016: $10,675,000) that will expire beginning in 2026 through 2036, unclaimed research and development costs of $10,830,000 (2016: $10,830,000) with no expiry, investment tax credits of $1,726,000 (2016: $1,726,000) which expire beginning in 2017 through 2032, and deductible temporary differences of $35,058,000 (2016: $23,133,000).

The company has recognized $Nil (2016: $Nil) in deferred income tax liabilities in relation to the fair value of the intangible lease.

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Statutory tax rate	**26.00%**	26.00%
Recovery at statutory rate	**$(15,205)**	$(5,189)
Change in unrecognized deferred income tax assets	**15,964**	6,044
Benefit of losses not previously recognized	**-**	(477)
Tax rate differences	**(959)**	(807)
Other permanent differences	**200**	429
Tax expense	**-**	-

30. Related Party Transactions

a) During the year ended December 31, 2017, 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, 2017 amounted to $437,000 (December 31, 2016: $337,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2017 are $Nil (December 31, 2016: $376,000). These fees are included in the Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amount to $61,000 for the year ended December 31, 2017 (December 31, 2016: $701,000).

b) 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	**2017**	2016
Salaries and other short-term employee benefits	**$2,285**	$2,186
Contributions to defined contribution plan	**75**	69
Option-based awards	**659**	1,332
	3,019	3,587

c) Loans to related parties

The balance of loans receivable from key management as at December 31, 2017 is $15,000 (December 31, 2016: $15,000). These loans are unsecured and payable on demand.

Other related party transactions are disclosed elsewhere in these consolidated financial statements (notes 22 and 24).

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

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

31. 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.

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

FOR THE YEAR ENDED DECEMBER 31	**2017**	2016
Weighted average number of common shares for basic earnings per share	**318,019,396**	306,611,069
Effect of dilution:		
Warrants	**-**	-
Share options	**-**	-
Weighted average number of ordinary shares adjusted for the effect of dilution	**318,019,396**	306,611,069

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.

32. Economic Dependence and Segmented Information

The Company reports financial performance based on three reportable segments as detailed below. The Company's Chief Operating Decision Maker ("CODM") utilizes Operating Income Loss as a primary measure of profitability to evaluate performance of its segments and allocate resources:

- The Avcorp Structures & Integration ("ASI") segment, which is dedicated to metallic and composite aerostructures assembly and integration.
- The Comtek Advanced Structures Ltd. ("Comtek") segment, within which exists two divisions dedicated to aircraft structural component repair services, and Avcorp Engineered Composites ("AEC") dedicated to design and manufacture of composite aerostructures.
- The Avcorp Composite Fabrication Inc. ("ACF") segment is dedicated to advanced composite aerostructures fabrication.

No operating segments have been aggregated to form the above reportable operating segments. Corporate includes general corporate administrative costs and any other costs not identifiable with one of the Company's segments.

The Company's Board of Directors monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss and is measured consistently with operating profit or loss in the Consolidated Statements of Loss and Comprehensive Loss.

a) Sales to five major customers for the year ended December 31, 2017, which comprise several programs and contracts, accounted for approximately 82.8 % (December 31, 2016: 70.7%) of sales.

F**OR THE YEAR ENDED DECEMBER 31**	**2017**		2016	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$5,413**	**3.6**	$5,352	2.9
Boeing[1]	**59,089**	**39.5**	80,735	43.9
Bombardier	**19,134**	**12.8**	15,332	8.4
Lockheed Martin	**15,735**	**10.5**	12,659	6.9
Subaru Corporation	**24,566**	**16.4**	15,789	8.6
Other	**16,449**	**11.0**	20,821	11.3
Amortization and contract renegotiation of the unfavourable contract liability	**9,058**	**6.2**	33,019	18.0
Total	**149,444**	**100.0**	183,707	100.0

1. Includes Boeing program partner revenue

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

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

FOR THE YEAR ENDED DECEMBER 31	2017		2016	
	Revenue	% of Total	Revenue	% of Total
Canada	**$26,498**	**17.7**	$21,616	11.8
USA	**80,976**	**54.2**	96,767	52.6
Europe	**6,375**	**4.3**	14,184	7.7
Asia	**26,016**	**17.3**	17,438	9.5
Australia	**358**	**0.2**	515	0.3
Other	**163**	**0.1**	168	0.1
Amortization and contract renegotiation of the unfavourable contract liability	**9,058**	**6.2**	33,019	18.0
Total	**149,444**	**100.0**	183,707	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 and in the United States.

FOR THE YEAR ENDED DECEMBER 31	2017	2016
Canada	**$62,365**	$61,701
USA	**50,886**	71,375
Total	**113,251**	133,076

The Company operates from two locations in Canada and one in the United States. Located in Delta, British Columbia, Avcorp Industries Inc., named as Avcorp Structures & Integration ("ASI"), is dedicated to metallic and composite aerostructures assembly and integration. Within Comtek Advanced Structures Ltd. ("Comtek"), located in Burlington, Ontario, exists two divisions dedicated to aircraft structural component repair services, and Avcorp Engineered Composites ("AEC") dedicated to design and manufacture of composite aerostructures. Located in Gardena, California, Avcorp Composite Fabrication Inc. ("ACF") is dedicated to advanced composite aerostructures fabrication.

Revenues, income loss and total assets are distributed by operating segment as noted in the tables below. Intercompany revenues and cost of sales are eliminated from the operating results presented.

FOR THE YEAR ENDED DECEMBER 31, 2017	Total	ASI	Comtek	ACF[1]	Corporate
Revenue	**$149,444**	$51,485	$18,076	$79,883	$-
Cost of sales	**181,296**	58,353	15,472	107,471	-
Gross (loss) profit	**(31,852)**	(6,868)	2,604	(27,588)	-
Selling, general, and admin expense	**21,580**	5,124	2,472	5,379	8,605
Depreciation and amortization	**341**	213	60	68	-
Operating (loss) gain	**(53,773)**	(12,205)	72	(33,035)	(8,605)

1. ACF revenue includes $9,058,000 amortization of the unfavourable contract liability.

FOR THE YEAR ENDED DECEMBER 31, 2016	Total	ASI	Comtek	ACF[1]	Corporate
Revenue	**$183,707**	$46,483	$19,491	$117,733	$-
Cost of sales	**175,333**	46,729	15,311	113,294	-
Gross (loss) profit	**8,374**	(246)	4,180	4,440	-
Selling, general, and admin expense	**24,429**	6,849	2,795	8,506	6,279
Depreciation and amortization	**350**	281	57	12	-
Operating (loss) gain	**(16,405)**	(7,376)	1,328	(4,078)	(6,279)

1. ACF operating (loss) includes $38,937,000 amortization and contract recognition of the unfavourable contract liability; $33,019,000 in revenue, $3,917,000 in cost of sales, and $2,001,000 in selling, general, and administration expense.

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

FOR THE YEAR ENDED DECEMBER 31	**2017**		2016	
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$50,814**	**44.9**	$38,737	29.1
Comtek Advanced Structures Ltd.	**10,197**	**9.0**	10,632	8.0
Avcorp Composite Fabrication Inc.	**52,122**	**46.0**	71,375	53.6
Corporate	**143**	**0.1**	12,332	9.3
Total	**113,251**	**100.0**	133,076	100.0

FOR THE YEAR ENDED DECEMBER 31	**2017**			2016	
	Development Cost Additions	**Property, Plant and Equipment**	**Intangible Asset Additions**	Development Cost Additions	Property, Plant and Equipment
Avcorp Industries Inc.	**$4,929**	**$1,325**	**$-**	$2,550	$463
Comtek Advanced Structures Ltd.	**418**	**408**	**-**	67	325
Avcorp Composite Fabrication Inc.	**-**	**1,321**	**571**	-	6,048
Total	**5,347**	**3,054**	**571**	2,617	6,836

FOR THE YEAR ENDED DECEMBER 31	**2017**		2016	
	Total Liabilities	**% of Total**	Total Liabilities	% of Total
Avcorp Industries Inc.	**$31,946**	**18.7**	$21,345	15.3
Comtek Advanced Structures Ltd.	**3,545**	**2.1**	3,537	2.5
Avcorp Composite Fabrication Inc.	**71,116**	**41.7**	90,749	64.8
Corporate	**64,074**	**37.5**	24,328	17.4
Total	**170,681**	**100.0**	139,959	100.0

33. Business Acquisition

Effective December 18, 2015, Avcorp completed the acquisition of Hitco (the "Acquisition"). The Acquisition was completed pursuant to the terms of an asset purchase agreement (the "Agreement") that was entered into on July 20, 2015, with subsequent amendments to December 18, 2015. Pursuant to the Agreement Avcorp's subsidiary ACF, purchased the assets of the division of Hitco which produces composite structural parts for commercial and military aerostructures (the "Business").

As a result of potential product quality and warranty claims, in addition to the liabilities assumed in the transaction, the Company may be involved in, or subject to, other disputes, claims and proceedings that arise in connection with the business acquired, including some that Avcorp asserts against others. The ultimate resolution of, and liability and costs related to these matters, at this time is undeterminable.

Pursuant to the asset purchase agreement, Hitco's direct and indirect parent companies have guaranteed certain of Hitco's obligations to Avcorp under the Agreement, including Hitco's indemnity obligations to Avcorp for Avcorp's losses stemming from product quality and warranty claims pertaining to finished goods delivered by Hitco before the closing date and certain finished goods manufactured by Hitco before the closing date that were designated as conforming inventory.

Included in the finalized unfavourable contract liability balance of $100,582,000 is an amount related to extraordinary inspection costs incurred by the Company in order to address certain product quality and warranty claims associated with non-conforming finished goods discovered subsequent to the closing of the Acquisition. The extraordinary inspection costs have been recognized based on management's best estimate and there exists significant measurement uncertainty relating to potential future product quality and warranty claims. Although the ultimate result and timing of potential additional claims and the amounts at which they may be settled cannot be determined, management believes that there is a possibility that the costs that may be incurred to settle these claims are material. Management intends to pursue recovery of the direct and consequential damages incurred in relation to this matter.

Included in the finalized unfavourable contract liability balance is a provision for management's best estimate of the expected costs for the foregoing product quality and warranty claims however the Company has not disclosed the information usually required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on the grounds that it can be expected to prejudice seriously the outcome of possible litigation related to this matter.

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

The Acquisition was accounted for as a business combination, using the acquisition method. The purchase consideration provided was allocated to the fair values of the identifiable assets acquired and liabilities assumed as follows:

	December 18, 2015		
	As Previously Reported	Adjustment	Final
Cash	$32,826	$-	$32,826
Consideration receivable	39,013	-	39,013
Consideration	**71,839**	**-**	**71,839**
Assets purchased			
Accounts receivable	18,799	-	18,799
Inventories and prepayments	19,763	(748)	19,015
Current Assets	**38,562**	**(748)**	**37,814**
Equipment	22,112	(242)	21,870
Intangible – lease	3,109	(2,356)	753
Intangible – customer contract re-compete	10,040	(4,323)	5,717
Intangible – customer order backlog	3,068	(3,068)	-
Goodwill	-	-	-
Total assets purchased	**76,891**	**(10,737)**	**66,154**
Liabilities assumed			
Accounts payable and accrued liabilities	17,431	1,027	18,458
Customer advance	23,428	(4,475)	18,953
Unfavourable contracts liability	90,654	9,928	100,582
Deferred income tax liability	1,244	(1,244)	-
Total liabilities assumed	**132,757**	**5,236**	**137,993**
Net liabilities	**(55,866)**	**(15,973)**	**(71,839)**
Gain on acquisition	**15,973**	**(15,973)**	**-**

On the acquisition of Hitco on December 18, 2015, Avcorp assumed the unfavourable contract liability and customer advance arising from specific customer contracts.

Adjustments of comparative amounts:

i. In previously filed financial statements the Company recorded the foreign exchange gain on these acquired liabilities through the statement of operations. Upon further analysis in 2017, it was determined that the foreign exchange gains on these items should have been recorded through other comprehensive income in the statement of equity. As a result the Company has corrected the classification of $3,995,000 from foreign exchange gain to other comprehensive income in the year ended December 31, 2016 (January 1, 2016: $861,000).

	January 1, 2016		
	As Previously Reported	Adjustment	Final
(Deficiency) Equity			
Deficit	$(77,827)	(861)	$(78,688)
Accumulated Other Comprehensive Income	-	861	861

	December 31, 2016		
	As Previously Reported	Cumulative Adjustment	Final
(Deficiency) Equity			
Deficit	$(93,791)	$(4,856)	$(98,647)
Accumulated Other Comprehensive Income	(138)	4,856	4,718

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

	December 31, 2016		
	As Previously Reported	Adjustment	Final
Consolidated statement of loss and comprehensive loss			
Foreign exchange (gain) loss	$(717)	$3,995	$3,278
Net loss for the year	(15,964)	(3,995)	(19,959)
Other comprehensive (loss) income	(138)	3,995	3,857
Loss per share			
Basic and diluted loss per common share	(0.05)	(0.02)	(0.07)

	December 31, 2016		
	As Previously Reported	Adjustment	Final
Consolidated statement of cash flow			
Net loss for the year	$(15,964)	$(3,995)	$(19,959)
Unrealised foreign exchange	(2,860)	3,995	1,135

34. Subsequent Events

a) On March 28, 2018, the Company entered into an amendment to its existing credit facility ("Revolving Loan") with a Canadian chartered bank whereby the following amendments were made:

- Availability under the Revolving Loan is increased by USD$10,000,000 ("Expanded Loan") subject to existing drawdown provisions, interest rates and bonus fees (note 16);
- Drawdowns under the Expanded Loan are supported by a major and material customer of the Company by way of a guarantee; and
- The Expanded Loan matures on March 31, 2019.

b) On May 25, 2018, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendment was made:

- Maximum availability under the Revolving Loan cannot exceed USD$68,000,000 less USD$4,300,000, until August 31, 2018, at which time the agreement reverts back to existing terms.

notes

AVCORP INDUSTRIES INC.

BOARD OF DIRECTORS AND OFFICERS

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

Elizabeth Otis (1)(2*)
DIRECTOR
Palm Springs, California

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

Peter George
DIRECTOR
Lake Tapps, Washington

Ken Robertson (1*)
DIRECTOR
Vancouver, British Columbia

MANAGEMENT

Amandeep Kaler
Avcorp Group Chief Executive Officer
Surrey, British Columbia

Edward Merlo
CORPORATE SECRETARY
Avcorp Group Chief Financial Officer
Richmond, British Columbia

Brent Collver
President
Comtek Advanced Structures Ltd.
Oakville, Ontario

Jim Renaud
General Manager
Avcorp Composite Fabrication Inc.
Huntington Beach, California

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

* Designates the Committee Chair

DIRECTORY

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

Ernst & Young LLP
Chartered Professional Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Registrar and Transfer Agent

AST Trust Company (Canada)
Vancouver, British Columbia

Bank

Royal Bank of Canada
Richmond, British Columbia

Avcorp Industries Inc.

10025 River Way
Delta, British Columbia
Canada V4G 1M7

Telephone: 604-582-6677
Facsimile: 604-582-2620
Email: info@avcorp.com
Website: www.avcorp.com

www.avcorp.com

www.avcorp.com