



Annual Report
2021

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CEO's Letter to Shareholders

2021 was a challenging year. The aerospace industry is constantly changing and adjusting to many variable factors such as geopolitical tensions, fuel prices, emergence of new players and consolidations. Along with the suffering caused by the COVID-19 virus, like many other industries and our peers, the aerospace sector suffered collapsing demand for commercial air travel. A full recovery in the commercial aerospace sector is several years away, yet we are seeing encouraging signs of demand coming back. The industry fully expects that commercial air travel will return to a historical long term growth trend as the vaccination rates increase and travel restrictions related to COVID-19 are lifted.

In 2021, Avcorp took significant steps forward. Fortunately for Avcorp, the demand in defense market remained strong during the year. Over the past year, the employees and management of Avcorp have continued to give great efforts to improve productivity, reduce operating costs, consolidation of facility footprint and reduce general and administrative costs. To strengthen our economic future, during the past year, Avcorp was successful in negotiating a multiparty agreement to improve its balance sheet and provide additional liquidity if required. This agreement eliminated a significant portion of the accrued interest costs and the fees that were payable in the future. The Company also extended its loan agreement to June 2023 with its biggest lender.

An important milestone was reached in 2021 when Avcorp celebrated the 10th anniversary of the first delivery of F-35 Outboard Wing assembly to BAE Systems.

During 2021, Avcorp was successful in negotiating new contracts and contract renewals. These contract performance periods extend to 2027 and beyond. These renewals provide significant firm revenue backlog for the future. Current order backlog as of December 31, 2021, is \$457 million. As the demand for the commercial air traffic improves and OEM production rates increase for both commercial and defense programs, the Company is expecting +20% annual growth in revenue in the coming couple of years. With the expected growth in revenue and full impact of the cost cutting initiatives undertaken by the management, the Company expects significant improvement in net cash from operating activities in the coming years. Based on the current expectations of the operational performance, the Company expects to repay any outstanding banking indebtedness by fiscal year 2026.

It is a challenge that I know our dedicated team is up to. I am grateful for the team's resilience and dedication for going above and beyond in supporting and providing "Better Solutions" to our customers.

These are very challenging times for the industry but also interesting and exciting times at Avcorp. We are strategically positioned to take advantage of the opportunities and have a dedicated and committed team to make the required difference.

I thank our employees, management, the Board, and all shareholders for their continued support in the future.

Amandeep Kaler, CEO, March 24, 2022

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 65 years of experience, over 450 skilled employees and 560,000 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, and 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 ("MD&A") has been prepared as of March 24, 2022 and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2021.

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 guided 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" or "Delta facility"), is dedicated to metallic and composite aerostructures assembly and integration. Comtek Advanced Structures Ltd., located in Burlington, Ontario, ("Comtek" or "Burlington facility") is dedicated to aircraft structural component repair services, and design and manufacture of composite aerostructures. Located in Gardena, California, Avcorp Composite Fabrication Inc. ("ACF" or "Gardena facility") 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.

2021 Highlights

- 2021 revenue was \$99,476,000 compared to \$150,962,000 in 2020. 2021 revenue decreased by \$51,486,000, in comparison to 2020. The decrease in revenue in 2021 was due to COVID-19 impact on customer requirements and the recognition of variable consideration on the contract termination of convenience in 2020. In addition, the Gardena facility's revenue decreased as it has fulfilled the remaining customer requirements on a contract and Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from the Gardena facility.
- 2021 net loss was \$531,000 compared to net loss of \$6,725,000 in 2020. The net loss improved by \$6,194,000 in comparison to 2020, mainly supported by the Accommodation Agreement settlement of \$21,391,000 and the decrease in net financing charge of \$4,514,000; offset by the impairment of assets in the Gardena facility, higher administrative and general expenses, a decrease in government grants, and the recognition of variable consideration on the termination of convenience in 2020.
- On March 12, 2021, the Company entered into a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V.
 - Panta Canada B.V. has agreed to provide a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate availability of USD \$13,000,000.
 - The elimination of an unamortized cash advance, mutual release and forgiveness of certain historic and future guarantee fees payable to the customer, and a legal claim.
- On February 25, 2021, the Company amended the Avcorp Composite Fabrication Inc.'s Gardena facility lease agreement effective January 1, 2021 to vacate certain buildings, reduce shared operating expenses, and reduced the lease term.
- On March 15, 2021, the Company received a \$2,508,000 (USD \$2,000,000) second wave Small Business Administration Paycheck Protection Program Loan and has recognized the amount as other income in the year ended December 31, 2021 as the company determined it has satisfied the requirements of loan forgiveness.
- On June 8, 2021, the Company received approval for forgiveness on the first wave Small Business Administration Paycheck Protection Program Loan full loan amount of USD \$4,123,000. An amount of \$4,601,000 (USD \$3,430,000) was recognized as other income in the year ended December 31, 2020, the Company recognized the remaining portion of loan forgiveness and related interest of \$924,000 (USD \$737,000) as other income in the year ended December 31, 2021.
- On June 22, 2021, the Company amended its loan agreement with a Canadian Chartered Bank to extend the maturity date of the existing loan agreement to June 30, 2023, which is supported by a major and material customer of the Company by way of a guarantee and recorded a modification gain of \$1,155,000 (USD \$932,000).
- On June 28, 2021, the Company received an award letter from BLR Aerospace to produce Wingtips with estimated first delivery by the second quarter of 2022.
- In August 2021, the Company signed a contract extension with Boeing to provide the Wheel Well Fairing assemblies for the Boeing 737 MAX aircraft.

Financial Overview

Three-Year Results

The following table provides selected financial information for the three years to December 31, 2021.

THREE-YEAR RESULTS

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

FOR THE YEAR ENDED DECEMBER 31

	2021	2020	2019
OPERATIONS			
Revenue	\$99,476	\$150,962	\$164,770
EBITDA ¹	11,207	19,492	10,813
Operating income (loss)	2,686	2,371	(1,124)
Net (loss) income	(531)	(6,725)	(9,316)
Basic and diluted (loss) income per share	(0.00)	(0.02)	(0.03)
FINANCIAL POSITION			
Capital expenditures	2,221	1,769	904
Total assets	102,637	121,538	128,140
Bank indebtedness and term debt	103,609	112,744	115,086
Shareholders' (deficit)	(48,107)	(49,140)	(43,475)
Net book value per share ²	(0.13)	(0.13)	(0.12)
Current ratio: current assets/current liabilities	1.18	0.47	0.47
Shares outstanding at period end	370,931,120	368,118,620	368,118,620

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS"), refer to page 9.
2. Net book value per share is not a recognized term under IFRS, refer to page 12.

For the year ended December 31, 2021, the Avcorp Group's revenue was \$99,476,000 compared to \$150,962,000 in 2020 and \$164,770,000 in 2019. The decrease in revenue in 2021 and 2020 compared to 2019 was mainly attributed to lower deliveries caused by lower customer requirements due to the impact of Coronavirus ("COVID-19"). In addition, the 2020 revenue included the recognition of variable consideration on the contract termination of convenience. The Gardena facility's revenue decreased as it has fulfilled the remaining customer requirements on a contract and Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from the Gardena facility.

For the year ended December 31, 2021, the Avcorp Group recorded income from operations of \$2,686,000 (December 31, 2020: \$2,371,000). Operating income in 2021 increased slightly over 2020 mainly due to the inclusion of the Accommodation Agreement settlement of \$21,391,000, offset by lower gross profit of \$8,303,000 and impairment loss of \$7,815,000 driven from the Gardena facility, lower other income of \$3,462,000 and higher administrative and general expenses of \$1,560,000.

The decrease in the operating loss in 2020 compared to 2019 is due to continued operational improvement, cost reduction initiatives, growth in defence program revenue, and the recognition of variable consideration on the contract termination of convenience. The 2019 \$1,124,000 operating loss contains \$17,325,000 net claim settlement gain.

Bank indebtedness and term debt has decreased by \$9,135,000 in 2021 compared to 2020. The decrease in bank indebtedness is mainly due to the net repayment of \$839,000, and a reduction upon recognition of a modification gain of \$1,155,000 (USD \$932,000) as a result of executing a loan amendment during the year. The decrease in term debt was mainly contributed by the revaluation of the Gardena facility lease during the year upon executing a lease amendment effective January 1, 2021 to vacate certain buildings and reduced the lease term.

The improvement in current ratio in 2021 to 1.18 from 0.47 in both 2020 and 2019 is mainly due to the reclassification of bank indebtedness as non-current in 2021 as a result of executing a loan amendment to extend the maturity to June 30, 2023. The current ratio is calculated by current assets divided by current liabilities.

Capital expenditures during the three-year period presented have been limited to upgrading and sustaining manufacturing equipment and capabilities, new program introductions, and information technology assets.

Total assets have decreased by \$18,901,000 in 2021 compared to 2020, mainly contributed by the decrease in assets in ACF. The impairment assessment of ACF determined the right-of-use assets, plant and equipment and intangible assets are impaired due to historical operating losses and lower forecasted revenue. Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from ACF affecting current and forecasted revenue in ACF. An impairment of \$7,815,000 was recognized in 2021.

Impact of COVID-19

In March 2020, the World Health Organization ("WHO") declared the COVID-19 virus a global pandemic. The ongoing COVID-19 pandemic, including the emergence of new variants, continues to negatively impact the global economy, global supply chains, the aviation industry particularly in the commercial airline industry, and create economic uncertainty. Governments worldwide have enacted emergency measures including travel bans, social distancing measures and mandatory quarantine requirements. Avcorp's operations in 2020 and 2021 at varying times have been challenged with reduced production driven by customers' build rate adjustments, government related enacted measures to modify work practices to meet health and safety standards, and related supply chain issues.

The Company has been closely monitoring and actively implementing and updating its response to the evolving COVID-19 pandemic and its impacts on employees and operations. Avcorp has implemented additional safety, sanitization and physical distancing procedures, including remote work schedules where possible and ceased all non-essential business travel. The Company has formed a committee composed of the senior leadership team in the organization to monitor the evolution of the pandemic, to evaluate the measures being put in place by local, provincial/state and national governments and the resulting impacts on the Company and to implement necessary contingency plans as the current situation continues to evolve, with a focus on protecting our employees' health and safety; supporting customers; and ensuring that the Company can successfully navigate through this global crisis. The Company actions are closely aligned with both the health and safety mandates that have been announced by the local or provincial/state health authorities.

There continues to be positive signs of market recovery and recovering air travel into 2022. The Company will continue to implement measures to align its cost structure and maximize cash preservation during the current market conditions to ensure it emerges from the current crisis on solid footing. The situation remains dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company remains unknown at this time.

Quarterly Results

The following table provides selected quarterly consolidated financial information for the eight most recent fiscal quarters to December 31, 2021, 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)

FOR THE 3 MONTHS ENDED	2021				2020			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Revenue	\$25,253	\$25,905	\$24,385	\$23,933	\$44,742	\$33,769	\$32,246	\$40,205
Operating (loss) income	(12,020)	(1,590)	(1,978)	18,274	8,477	(326)	(1,080)	(4,700)
EBITDA ¹	(10,248)	243	538	20,674	17,895	3,623	2,937	(4,963)
Net (loss) income	(13,537)	(3,172)	(1,212)	17,390	6,546	(1,263)	(1,594)	(10,414)
EBITDA per share ¹								
Basic	(0.03)	0.00	0.00	0.06	0.05	0.01	0.01	(0.01)
Diluted	(0.03)	0.00	0.00	0.06	0.05	0.01	0.01	(0.01)
Net (loss) income per share								
Basic	(0.04)	(0.01)	(0.00)	0.05	0.02	(0.00)	(0.00)	(0.03)
Diluted	(0.04)	(0.01)	(0.00)	0.05	0.02	(0.00)	(0.00)	(0.03)
Long-term debt ²	100,568	100,212	13,123	15,364	19,168	24,801	25,240	35,358

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS") – refer to page 9.

2. Long-term debt at the end of the third and fourth quarter of 2021 includes bank indebtedness classified as non-current upon the loan maturity extension to June 30, 2023 and non-current term debt.

The quarterly revenue in 2020 decreased in the second quarter of 2020 onwards due to the COVID-19 pandemic, detrimentally impacting Commercial program revenues. The fourth quarter of 2020 showed strong revenue and net income performance as it included an estimate of variable consideration related to a contract termination of convenience. Variable consideration is estimated as the most likely amount to which we expect to be entitled and is recognized to the extent it is probable that a significant reversal will not occur when the uncertainty associated with the variable. Quarterly revenue in 2021 show continued improvement from the first quarter in 2021 as the F35 program in the Delta facility continues to grow, offset by lower commercial customer requirements due to the impact of COVID-19 and fulfilling the remaining defence customer requirements at the Gardena facility.

During the second quarter of 2020, Avcorp implemented cost savings initiatives designed to reduce operating costs and rebalanced its workforce upon the onset of COVID-19. Avcorp applied for Canadian and United States government subsidies in the amount of \$8,220,000 recognized in 2021 and \$11,397,000 recognized in 2020 to other income. The fourth quarter of 2020 recognized government grants of \$7,761,000 compared to the fourth quarter of 2021 of \$208,000.

The first quarter of 2021, Avcorp entered into a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V. This provided a gain to operating income of \$21,391,000 with the elimination of an unamortized cash advance, mutual release and forgiveness of certain historic and future guarantee fees payable to the customer, and a legal claim.

For the quarter ended December 31, 2021, the Avcorp Group recorded loss from operations of \$12,020,000 (December 31, 2020: \$8,477,000 income). The impairment assessment of ACF determined the right-of-use assets, plant and equipment and intangible assets are impaired due to historical operating losses and lower forecasted revenue. Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from ACF affecting current and forecasted revenue in ACF. An impairment write-off of \$7,815,000 was recognized in the fourth quarter of 2021. The Company expensed \$2,558,000 of overhead costs during the fourth quarter 2021 (2020: \$2,684,000) in respect of unutilized plant capacity. Provision for onerous contracts accrued during the fourth quarter 2021 totaled \$1,064,000 (December 31, 2020: \$188,000).

Revenue

For the year ended December 31, 2021, revenues totaled \$99,476,000, a \$51,486,000 decrease in revenues relative to 2020 (December 31, 2020; \$150,962,000).

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

	2021		2020	
	Revenue	% of Total	Revenue	% of Total
Avcorp Structures & Integration. (ASI)	\$75,976	76.4	\$86,756	57.5
Comtek Advanced Structures Ltd. (AEC)	13,373	13.4	16,509	10.9
Avcorp Composite Fabrication Inc. (ACF)	10,127	10.2	47,697	31.6
Total	99,476	100.0	150,962	100.0

The Company operates within "general terms agreements" with its customers. These typically have a duration of five or more years. The contracts provide long lead-time orders; the civil aerospace business is slightly seasonal as some aircraft manufacturers reduce or suspend production in December and for a period of time during the summer months.

Delta facility revenues for 2021 totaled \$75,976,000 (December 31, 2020: \$86,756,000).

Delta facility commercial aircraft programs production revenues have decreased by \$495,000 in 2021 relative to 2020. In addition, production for defence programs decreased by \$10,285,000 in 2021 relative to 2020 due to the recognition of an estimate of variable consideration related to a contract termination of convenience in 2020. The F-35 program revenue continued to increase in 2021 as the ramp up in production continued, expansion of the F-35 work cell, and utilization of additional tooling sets received. Production of the Boeing 737 Max programs increased in the second half of 2021 as delivery requirements begin to return.

Avcorp's Delta location continues to actively pursue aerospace production contracts throughout North America, Asia, and Europe in both 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.

Burlington facility revenues for 2021 totalled \$13,373,000 (December 31, 2020: \$16,509,000).

The Burlington facility is dedicated to aircraft structural component repair services, and design and manufacture of composite aerostructures. They service customers from around the world.

The Burlington facility revenues decreased by \$3,136,000 during the current year relative to the year ended December 31, 2020 due to the impact of COVID-19. The primary decrease was in composite floor panels revenue.

Gardena facility revenues for 2021 totaled \$10,127,000 (December 31, 2020: \$47,697,000).

The Gardena facility provides a unique aerostructures composite capability to 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 enhance Avcorp Group's ability to participate in large aerospace assembly programs which combine mixed material components.

For the year ended December 31, 2021, revenues arising from the assignment by customers of commercial aerospace contracts to Avcorp Industries Inc. for which the production occurs in Gardena facility have generated \$4,852,000 in production revenue (December 31, 2020: \$18,382,000). Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from the Gardena facility; consequently, the Gardena facility has not made any shipments on this program since August 2021. Avcorp is working closely with Subaru to ensure a continued steady rate of supply. The Gardena facility defence aerospace contracts generated \$5,275,000 of production revenue during the year ended December 31, 2021, for ACF (December 31, 2020: \$29,316,000). These contract revenues have decreased from 2020 as the remaining customer contract requirements were fulfilled in 2021. Follow-on purchase orders and contract extensions are in discussions with the customer; however, the Company cannot provide any assurance of the outcome. Avcorp received a follow-on purchase order with delivery requirements into the first quarter of 2022.

Deliveries and quality performance as at December 31, 2021 for Avcorp manufacturing operations were at customer required levels. Manufacturing operations have achieved, and continue to maintain, top quality and delivery ratings for the majority of their programs.

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

	2021		2020	
	Revenue	% of Total	Revenue	% of Total
BAE Systems	\$40,508	40.7	\$31,332	20.8
Boeing ¹	26,047	26.2	48,237	31.9
Bombardier	10,796	10.9	12,998	8.6
Lockheed Martin	6,208	6.2	30,444	20.2
Subaru Corporation	4,299	4.3	16,311	10.8
Other	11,618	11.7	11,640	7.7
Total	99,476	100.0	150,962	100.0

1. Includes Boeing program partner revenue consisting of industry tier-one suppliers to Boeing.

The Avcorp Delta BC facility is the single source supplier for the F-35 carrier variant outboard wing (CV-OBW) assembly under contract with **BAE Systems ("BAE")** and delivers directly to **Lockheed Martin**. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35 aircraft which allows for handling and storage of the aircraft on the aircraft-carrier's deck and hangers, while keeping its long-range and low-landing-speed flight characteristics. The CV-OBW is regarded as one of the more complex assemblies that the Canadian aerospace industry contributes to the F-35 program. Production demand for the F-35 CV-OBW increased by \$9,176,000 relative to 2020. Production contracts have been secured through to end of the second fiscal quarter of 2022, with discussions underway with the customer to secure constant production through to 2026. 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 Lot Fourteen; and through an agreed record of negotiation Avcorp continues discussions with the customer for production under Lot Fifteen through Lot Seventeen.

Avcorp's Gardena California facility provided content for all three models of the F-35 fighter aircraft. Fabricated components include the wing skins 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 completed a multi-year contract with **Lockheed Martin Corporation**, who released order quantity and schedule requirements to the Company through to the end of the second fiscal quarter of 2021. Follow-on purchase orders and contract extensions are currently in discussions with the customer, however the Company cannot provide any assurance of the outcome. Avcorp received a follow-on purchase order with delivery requirements into the first quarter of 2022.

Shipments of large complex metal assemblies and fabricated parts and components out of the Delta facility to **Boeing Commercial Airplane Group ("BCA")**, primarily for the 737 commercial jet program, decreased by 47% in 2021 relative to 2020, primarily as a result of the continued reduced customer requirements for the Boeing 737 MAX and COVID-19. Total production deliveries generated for the Company from various Boeing Commercial aircraft programs amounted to \$21,132,000 for the year ended December 31, 2021 (December 31, 2020: \$23,728,000). In August 2021, the Company signed a multi-year contract extension with Boeing to provide the Wheel Well Fairing assemblies for the Boeing 737 MAX. The Company also delivers components to **Boeing Defence, Space & Security ("BDSS")** totaling \$4,915,000 of revenues, an increase in revenues relative to 2020 (December 31, 2020: \$2,718,000).

Production deliveries for **Bombardier Aerospace ("Bombardier")** programs decreased during the current year relative to the year ended December 31, 2020. Shipments of large assemblies for the CL605 business jet program increased by \$1,808,000 during the current year as demand for these products increased relative to 2020; which was offset by a \$4,010,000 decrease in its deliveries of composite panels and related products to Bombardier. Avcorp Group's primary source of revenue from Bombardier in 2022 will continue to be from components for the CL605 and CL850 business jets and composite floor panels for various Bombardier aircraft programs.

Avcorp's deliveries to **Subaru Corporation ("Subaru")** of large complex composite structural components are integrated into the center wing box in support of the Boeing 787 commercial jet program totaled \$4,299,000 for the current year (December 31, 2020: \$16,311,000); a decrease as a result of decreased customer demand due to COVID-19 and ongoing delivery delays by the customer. Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from the Gardena facility; consequently, the Gardena facility has not made any shipments on this program since August 2021. Avcorp is working closely with Subaru to ensure a continued steady rate of supply. This is a significant commercial production contract component being manufactured in the Gardena facility for the life of the individual aircraft program contract. This long-term agreement represents an important relationship with a long-standing industry Tier 1 supplier.

Composite aircraft structure repair revenues out of Comtek decreased by 8% relative to revenues in the previous year. The Avcorp Group also supplies Canadian aircraft retrofit programs out of its Delta facility, and large composite structures in support of various U.S. defence programs out of its Gardena facility, whose revenues decreased relative to 2020. These **Other** revenues are significant to the Group's operations as they generated \$11,618,000 in revenue during the year ended December 31, 2021 (December 31, 2020: \$11,640,000).

Defence program revenues for the Avcorp Group in 2021 totaled \$52,992,000 (December 31, 2020: \$87,783,000); 53.3% of total production sales (December 31, 2020: 58.1%). **Commercial program sales** provided a lower percentage of the Company's sales in 2021 (December 31, 2021: 46.7%; December 31, 2020: 41.9%) amounting to \$46,484,000 for 2021 and \$63,179,000 for 2020. The Group continues to move forward with revenue diversification between commercial and defence aerospace programs.

Gross Profit

Gross profit (revenue less cost of sales) for the year ended December 31, 2021, was negative 0.1% of revenue compared to positive 5.5% of revenue for the year ended December 31, 2020.

The Gardena facility gross margin for 2021 was negative \$11,438,000 (December 31, 2020: \$5,223,000 negative gross margin). The gross margin decreased by \$6,215,000, mainly attributable to the decrease in revenue during the year. Avcorp is managing the cost structure in the Gardena facility due to the lower revenue by rebalancing the work force, signing a new lease agreement to reduce operating expenses, and working to secure additional production contracts. On February 25, 2021, the Company amended the Avcorp Composite Fabrication Inc.'s Gardena facility lease agreement effective January 1, 2021, to vacate certain under-utilized buildings and to reduce shared operating expenses. In addition, the Company sold several out of production pieces of equipment in those buildings to reduce unutilized plant capacity expense.

The Delta facility gross margin for 2021 was positive \$8,709,000 (December 31, 2020: \$10,888,000 positive gross margin). Delta gross margin decreased by \$2,179,000 from the previous year, mainly due to 2020 gross margin being supported by the inclusion of an estimate of variable consideration on a contract termination of convenience. The Delta facility continues to implement production methods to create efficiencies.

Burlington production contracts produced a positive gross margin of \$2,659,000 for the year ended December 31, 2021, as compared to a positive gross margin of \$2,568,000 in 2020. Gross margins for 2021 increased slightly by \$91,000 due to lower labour costs and product mix.

There is unutilized plant capacity within the Company's Delta, British Columbia facility, and within the Gardena, California facility. The Company has expensed \$10,112,000 of overhead costs during the year as compared to \$8,346,000 for December 31, 2020, in respect of unutilized plant capacity. The amount of these overhead costs expensed, because of unutilized capacity, will fluctuate as production in support of deliveries varies. Revenue growth in these facilities would benefit Company profitability by contributing to the recovery of fixed overhead expenditures. 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 manufacturing capabilities further leveraging existing production capacity and investments, in addition to, pursuing new work.

Administrative and General Expenses

As a percentage of revenue, administrative and general expenses increased to 18.4% for the year ended December 31, 2021, from 11.1% in 2020 as a result of the decrease in revenue. In absolute terms, administrative and general expenses increased by \$1,560,000 during the current year relative to 2020 mainly attributable to the recognition of stock-based compensation expense amounting to \$1,376,000 on the fair value of the immediately vesting options granted in 2021. Management have taken steps to manage expenses due to COVID-19 by reducing headcount and saving on various other expenses during the year.

Foreign Exchange Gain or Loss

During the year ended 2021, the Canadian dollar strengthened against the US dollar resulting in a gain attributable to the translation of the Company's US dollar denominated Bank indebtedness and Term debt. Avcorp Group recorded a \$295,000 foreign exchange gain during the year ended December 31, 2021, (December 31, 2020: \$364,000 loss) as a result of holding US dollar-denominated cash, receivables, payables and debt.

Finance Costs

Total interest and financing charges on bank indebtedness and current and non-current term debt for the year ended December 31, 2021, were \$3,091,000, which is net of \$5,000 interest income as compared to \$7,605,000 expense, net of \$122,000 interest income for the year ended December 31, 2020. Net interest expenditures have decreased relative to the previous year mainly due to the repayment of bank indebtedness and other term debt throughout 2020 and 2021, the removal of the loan guarantee fee payable to a customer as a result of the Accommodation Agreement signed on March 12, 2021, as well as a net gain on modification of bank indebtedness of \$1,155,000 as a result of executing an amending agreement during the year.

Income Taxes

Avcorp Group has not incurred a tax expense during the year ended December 31, 2021, (December 31, 2020: \$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, 2021, was \$531,000 compared to a loss of \$6,725,000 for the year ended December 31, 2020. The December 31, 2021 net loss contains \$21,391,000 from the Accommodation Agreement settlement, other income of \$8,180,000 and impairment loss of \$7,815,000.

On March 12, 2021, the Company entered into a multiparty amended and restated Accommodation Agreement with each of a customer, and Panta Canada B.V. whereby, inter-alia;

- Panta Canada B.V. has agreed to provide a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate availability of USD \$13,000,000; and
- The elimination of unamortized cash advance, mutual release and forgiveness of certain historic and future guarantee fees payable to the customer, and a legal claim provision. \$21,391,000 was released to the Consolidated Statements of Loss for the year ended December 31, 2021.
- The Company is required to use a portion of the variable consideration at the time of settlement of the termination of convenience towards permanently reducing the maximum availability of the guaranteed portion of the bank indebtedness.

The Canada Emergency Wage Subsidies from the Canadian Government for the year ended December 31, 2021, of \$4,389,000 were included in other income (December 31, 2020: \$6,796,000), \$394,000 of Canada Emergency Rent Subsidies was also included as other income in the year (December 31, 2020: \$Nil). There are no unfulfilled conditions or other contingencies attached to these grants.

On April 28, 2020, the Company received a loan in the amount of \$5,529,000 (USD \$4,123,000) from a U.S. Chartered Bank through the U.S. Small Business Administration Paycheck Protection Program ("PPP loan"). The Company has determined that \$4,601,000 (USD \$3,430,000) met the forgiveness criteria and the amount was included in the year ended December 31, 2020 as other income. On June 8, 2021, the Company received approval for forgiveness on the full loan amount of USD \$4,123,000. The Company recognized the remaining portion of loan forgiveness and related interest of \$924,000 (USD \$737,000) as other income in the year ended December 31, 2021.

On March 15, 2021, the Company received a \$2,508,000 (USD \$2,000,000) second wave PPP loan and has determined that the full loan amount and the related interests of \$2,513,000 (USD \$2,004,000) met the forgiveness criteria. The full loan amount and related interest is included in the year ended December 31, 2021 as other income.

On February 25, 2021, the Company amended the Avcorp Composite Fabrication Inc.'s Gardena facility lease agreement effective January 1, 2021, to vacate certain buildings by March 31, 2021, and reduced the lease term. As the lease modification is not accounted for as a separate lease, the Company remeasured the lease liability by discounting the revised lease payments on revised lease term and revalued the right of use asset with a loss on modification of \$204,000 of the lease recognized as other loss in the year ended December 31, 2021 (December 31, 2020: \$Nil).

The impairment assessment of ACF determined the right-of-use assets, plant and equipment and intangible assets are impaired due to historical operating losses and lower forecasted revenue. Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from ACF affecting current and forecasted revenue in ACF. A \$7,815,000 impairment loss was recognized in 2021.

The decrease in net loss for 2021 relative to 2020 was also contributed by the decrease in finance costs, increase in foreign exchange gain and lower loss on sale of equipment, offset by lower gross profit and higher administrative and general expenses.

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 or may not be comparable to similar financial measures disclosed by other issuers. However, the Company's management believes that the Company's stakeholders consider this metric to be useful information to assist the evaluation of profitability.

EBITDA was positive \$11,207,000 for the year ended December 31, 2021, compared to EBITDA of positive \$19,492,000 for the year ended December 31, 2020.

The decrease in EBITDA was mainly due to the decrease in revenue, decrease in other income, recognition of impairment loss and increase in administrative and general expenses, offset by the accommodation agreement settlement.

EBITDA¹

(expressed in thousands of Canadian dollars)

FOR THE YEAR ENDED DECEMBER 31

	2021	2020	2019
Loss for the year	\$(531)	\$(6,725)	\$(9,316)
Interest expense and financing charges	3,096	7,727	8,941
Income tax expense	-	-	-
Depreciation	7,147	8,338	8,218
Amortization of development costs and intangibles	1,495	10,152	2,970
	11,207	19,492	10,813

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

Capital Resources

On May 26, 2017, the Company entered into a loan agreement for an expanded operating credit facility with a Canadian Chartered Bank. This loan agreement was subject to a significant amendment on November 15, 2019. This loan agreement was further amended on June 22, 2021, to extend the maturity to June 30, 2023. The Company recorded a net gain on modification of bank indebtedness of \$1,155,000 (USD \$932,000) as a result of executing this amending agreement.

- Maximum availability under the Loan agreement cannot exceed USD \$68,000,000 less USD \$1,000,000 until June 30, 2023. USD \$45,000,000 borrowing capacity under the loan agreement is supported by a customer of the Company (the "Guarantor") by way of a guarantee (the "Guarantee"). On November 15, 2019, Panta Holdings B.V., the holding company of Panta Canada B.V. which is Avcorp's majority shareholder, entered into a guarantee agreement with the Guarantor. Pursuant to the guarantee agreement, Panta Holdings B.V. provided a guarantee to the Guarantor in the maximum payment of USD \$10,000,000 if the bank draws on the Guarantee in whole or in part.
- Interest rate for advances made up to the maximum of the allowable borrowing base of USD \$23,000,000 revolving loan less USD \$1,000,000:
 - Royal Bank Prime ("RBP") plus 1.50% per annum
 - Royal Bank US Base Rate ("RBUSBR") plus 1.50% per annum
 - Banker's Acceptance ("BA") Equivalent Rate plus 3.00% per annum
 - LIBOR Rate plus 3.00% per annum
- Interest rate for advances made on the additional USD \$45,000,000 borrowing capacity up to USD \$68,000,000.
 - 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
- The Company ended the year with bank operating line utilization of \$75,335,000 (USD \$59,421,000) offset by \$4,060,000 cash compared to utilization of \$76,439,000 (USD \$60,037,000) with \$7,044,000 cash on hand as of December 31, 2020. The bank indebtedness balance of the modification gain and related adjustments as a result of executing the amending agreement in 2021 was \$923,000 as at December 31, 2021, (December 31, 2020, loss of \$269,000 from 2019 amendment). As at the date of this report the Company is able to draw up to an additional \$3,092,000 (USD \$2,439,000) on its operating line of credit.

On March 12, 2021, the Company entered into a multiparty amended and restated Accommodation Agreement with each of a customer, and Panta Canada B.V. whereby, inter-alia;

- Panta Canada B.V. has agreed to provide a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate availability of USD \$13,000,000.

On March 15, 2021, the Company received a second wave Small Business Administration Paycheck Protection Program Loan in the amount of \$2,508,000 (USD \$2,000,000) to support Avcorp Composite Fabrication Inc ("ACF"). The Company has recognized full forgiveness of the loan in the year ended December 31, 2021, as the Company has satisfied the requirements of loan forgiveness.

The Company received the Canada Emergency Wage Subsidies and Canada Emergency Rent Subsidies in the amount of \$4,389,000 (December 31, 2020: \$6,796,000) and \$394,000 (December 31, 2020: \$Nil) respectively in the year ended December 31, 2021. The Company will continue to apply for additional government subsidies when eligible.

The Company has a working capital surplus of \$7,613,000 as at December 31, 2021, compared with \$77,780,000 deficit as at December 31, 2020. Working capital is defined as the difference between current assets and current liabilities. The increase compared to 2020 was mainly due to the bank indebtedness re-classified as non-current upon extension of maturity to June 30, 2023. On December 31, 2021, the ratio of the Company's current assets to current liabilities was 1.18:1 (December 31, 2020: 0.47:1). The Company's accounts receivable, government grant receivable, current contract assets, and inventories net of current accounts payable amount to a \$24,452,000 surplus as at December 31, 2021, (December 31, 2020: \$33,174,000 surplus).

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital, utilized \$699,000 during the year ended December 31, 2021 as compared to generating \$13,022,000 cash during the year ended December 31, 2020. Cash flows in 2021 included a receipt of Canada Emergency Wage and Rent Subsidies of \$6,814,000 (December 31, 2020: \$4,765,000).

Non-cash operating assets and liabilities generated \$5,602,000 of cash during the year ended 2021, compared to utilizing \$3,897,000 of cash during the previous year, primarily due to timing in payments to suppliers.

Avcorp Group continues to closely monitor accounts receivable and accounts payable, and to work with its customers and suppliers to ensure cash is collected on a timely basis and on payment terms that meet its operational needs.

Cash Flows from Investing Activities

During the year ended December 31, 2021, the Avcorp Group purchased equipment totalling \$2,221,000, of which \$147,000 was supported by government grant, compared with \$1,769,000 during the year ended December 31, 2020. Avcorp Group continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

During 2021 and 2020, the Company continued the new program introduction process in support of production contracts. The start-up of new production contracts requires significant investments in hard and soft tooling. Such tooling investments amounted to \$2,956,000 for the year ended December 31, 2021, (December 31, 2020: \$3,929,000).

The Gardena facility sold several out of production equipment for proceeds of \$852,000 during the year as it vacated unutilized buildings as part of the new lease agreement (December 31, 2020: \$Nil).

Cash Flows from Financing Activities

Avcorp Group finances working capital through a combination of government subsidies, shareholder loans, bank debt, and equity financings.

Cash flows from financing activities utilized \$3,707,000 of cash during the current year compared with utilizing \$740,000 of cash in 2020.

The Company's operating line was \$75,335,000 drawn as at December 31, 2021, (December 31, 2020: \$76,439,000). The Company drew \$1,266,000 in cash during the year (December 31, 2020: \$653,000 was drawn) and repaid \$2,105,000 in cash during the year (December 31, 2020: \$7,368,000 was repaid).

Repayment of term debt during the year ended December 31, 2021 amounted to \$3,047,000 (December 31, 2020: \$2,524,000); which was used to fund equipment and facility leases.

Proceeds from term debt during the current year amounted to \$2,508,000 (December 31, 2020: \$12,453,000), which represents the receipts of Paycheck Protection Program Loan from the U.S. Small Business Administration to ACF ("PPP Loan"). 2020 amount includes the drawdown of \$6,924,000 (USD \$5,250,000) of the 2019 Panta loan and receipts of \$5,529,000 (USD \$4,123,000) PPP loan.

Payment of interest during the year ended December 31, 2021 amounted to \$2,441,000 (December 31, 2020: \$3,954,000); Decrease in payment mainly attributable to repayment of bank indebtedness and term debt throughout 2020 and 2021.

During the year a holder of the Company's stock options exercised 2,812,500 stock options at a price of \$0.04 resulting in the issuance of 2,812,500 common shares with a value of \$112,000.

Contractual Obligations**PAYMENTS DUE BY PERIOD***(unaudited, expressed in thousands of Canadian dollars)*

	Total	Within 1 year	Between 1-5 years	Over 5 years
Lease obligations	\$11,750	2,712	6,487	2,551
Bank indebtedness	74,412	-	74,412	-
Term loan ¹	17,447	329	15,443	1,675
Purchase obligations ²	29,893	28,741	1,152	-
Total contractual obligations	133,502	31,782	97,494	4,226

1. This amount includes loan with a related party and obligations the Company has with Industrial Technologies Office.
2. Purchase obligations include payments for the Company's 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, nor does it have transactions that are not recorded or disclosed in the consolidated financial statements.

Capital Stock

As at December 31, 2021, there were 370,931,120 common shares, no common share purchase warrants, and 19,248,000 stock options issued and outstanding.

Common Shares

Panta Canada B.V., is wholly owned by Panta Holdings B.V. and is Avcorp's majority shareholder owning approximately 70.6% of issued and outstanding common shares as of December 31, 2021.

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 370,931,120 common shares issued at December 31, 2021 (December 31, 2020: 368,118,620 Common Shares). During the fourth quarter of 2021, a holder of the Company's stock options exercised 2,812,500 stock options at a price of \$0.04 resulting in the issuance of 2,812,500 common shares with a value of \$112,000.

The book value of common shares issued and outstanding as at December 31, 2021 was \$86,456,000 (December 31, 2020: \$86,219,000), and a shareholders' deficiency of \$48,107,000 (December 31, 2020: \$49,140,000 deficiency).

Accounting standards

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

Amendments to IAS 1: Classification of Liabilities as Current or Non-Current

In January 2020, the IASB issued Classification of Liabilities as Current or Non-current (Amendments to IAS 1). The amendments aim to promote consistency in applying the requirements by helping companies determine whether, in the statement of financial position, debt and other liabilities with an uncertain settlement date should be classified as current (due or potentially due to be settled within one year) or non-current. The amendments include clarifying the classification requirements for debt a company might settle by converting it into equity. The amendments are effective for annual reporting periods beginning on or after January 1, 2023, with earlier application permitted. The Company is currently assessing the impact and the timing to adopt this amendment.

Amendments to IAS 37: Onerous Contracts – Costs of Fulfilling a contract

In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making.

The amendments apply a "directly related cost approach". The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

The amendments are effective for annual reporting periods beginning on or after January 1, 2022, with earlier application permitted. The Company will apply these amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments. The Company presently applies a “directly related cost approach” to assess whether a contract is onerous and does not expect the adoption to have a significant impact on the Company’s consolidated financial statements.

Amendments to IAS 8: Definition of Accounting Estimates

In February 2021, the IASB issued amendments to IAS 8, in which it introduces a definition of ‘accounting estimates’. The amendments clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors. Also, they clarify how entities use measurement techniques and inputs to develop accounting estimates.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and apply to changes in accounting policies and changes in accounting estimates that occur on or after the start of that period. Earlier application is permitted as long as this fact is disclosed.

The Company is currently assessing the impact and timing of the amendments on current practice.

Amendments to IAS 1 and IFRS Practice Statement 2: Disclosure of Accounting Policies

In February 2021, the IASB issued amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements, in which it provides guidance and examples to help entities apply materiality judgements to accounting policy disclosures. The amendments aim to help entities provide accounting policy disclosures that are more useful by replacing the requirement for entities to disclose their ‘significant’ accounting policies with a requirement to disclose their ‘material’ accounting policies and adding guidance on how entities apply the concept of materiality in making decisions about accounting policy disclosures.

The amendments to IAS 1 are applicable for annual periods beginning on or after 1 January 2023 with earlier application permitted. Since the amendments to the Practice Statement 2 provide non-mandatory guidance on the application of the definition of material to accounting policy information, an effective date for these amendments is not necessary.

The Company is currently assessing the impact of the amendments to determine the impact they will have on the Company’s accounting policy disclosures.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at December 31, 2021, for Canadian and US 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.

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 to December 2027 with options to 2029. Agreements with Boeing Defence, Space and Security extend into 2022. The Bombardier and Subaru agreements extend for the life of the individual aircraft programs. Agreements with Lockheed Martin extend into 2022. Agreements with BAE Systems (Operations) Limited extend into 2022 and continue to generate additional sales order backlogs.

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, 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, 2021, is \$457 million in consideration of attaining full award values, compared to \$407 million as at December 31, 2020. The changes in order backlog are as follows:

- \$99 million decrease in order backlog resulting from revenues recorded during the year ended December 31, 2021;
- Insignificant impact 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.
- \$149 million increase in order backlog due to an increase in the production rates for existing commercial and defence programs, offset partially by decreases in several existing commercial program requirements;
 - In August 2021, the Company signed a contract extension with Boeing to provide the Wheel Well Fairing assemblies for the Boeing 737 MAX.
 - COVID-19 has significantly impacted the aviation and aerospace manufacturing industry, causing disruptions in production and slowing demand as workers go home, passengers stop travelling, and customers defer delivery of new aircraft. Some of the Company’s major commercial programs had previously reduced their production requirements and now are showing signs of recovery into 2022 to 2023.

Supply Chain

Supplier quality and delivery performance continued to meet targeted levels during the period; 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 Company during 2021 has had disruptions in the supply chain for chemicals and other raw materials due to COVID-19. Avcorp is working with suppliers to mitigate this new and evolving risk. There has not been a material impact to the supply chain.

The securing of additional long-term contracts with key suppliers continues. Critical supplier cost reduction initiatives are in process and continuing into the future.

Working Capital Utilization

Total current assets less total current liabilities were in a surplus position of \$7,613,000 at December 31, 2021, and a \$77,780,000 deficit position at December 31, 2020. On December 31, 2021, the ratio of the Company's current assets to current liabilities was 1.18:1 (December 31, 2020: 0.47:1). The Company's accounts receivable, government grant receivable, current contract assets, and inventories net of current accounts payable, amount to a \$24,452,000 surplus as at December 31, 2021, (December 31, 2020: \$33,174,000 surplus).

Financial Resources

Avcorp Group has invested in its strengths: 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 these 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, 2021, was 488 (December 31, 2020: 546). The decrease in the number of employees was due to reduced delivery requirements from customers affected by COVID-19.

Equipment, Systems, Technologies and Processes

Manufacturing equipment and information technology assets have been upgraded and further deployed, increasing reliability and utility when required limited by liquidity availability.

Risk Assessment

The principal risks that Avcorp Group faces are summarized as follows:

- additional financing is required to maintain and grow its business;
- adverse impact of COVID-19 on the aviation industry, employees, supply chain and customers;
- no agreement on extension of customer contracts, or terminated customer programs that are not replaced;
- availability of material and 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.

In March 2020, the World Health Organization ("WHO") declared the COVID-19 virus a global pandemic. The ongoing COVID-19 pandemic, including the emergence of new variants, continues to negatively impact the global economy, global supply chains, the aviation industry particularly in the commercial airline industry, and create economic uncertainty. Governments worldwide have enacted emergency measures including travel bans, social distancing measures and mandatory quarantine requirements. Avcorp's operations in 2020 and 2021 at varying times have been challenged with reduced production driven by customers' build rate adjustments, government related enacted measures to modify work practices to meet health and safety standards, and related supply chain issues.

The Company has been closely monitoring and actively implementing and updating its response to the evolving COVID-19 pandemic and its impacts on employees and operations. Avcorp has implemented additional safety, sanitization and physical distancing procedures, including remote work schedules where possible and ceased all non-essential business travel. The Company has formed a committee composed of the senior leadership team in the organization to monitor the evolution of the pandemic, to evaluate the measures being put in place by local, provincial/state and national governments and the resulting impacts on the Company and to implement necessary contingency plans as the current situation continues to evolve, with a focus on protecting our employees' health and safety; supporting customers; and ensuring that the Company can successfully navigate through this global crisis. The Company actions are closely aligned with both the health and safety mandates that have been announced by the local or provincial/state health authorities.

There continues to be positive signs of market recovery and recovering air travel into 2022. The Company will continue to implement measures to align its cost structure and maximize cash preservation during the current market conditions to ensure it emerges from the current crisis on solid footing. The situation remains dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company remains unknown at this time.

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;
- finance business acquisitions.

The Avcorp's Canadian operations are currently working to secure additional financing through the Aerospace Regional Recovery Initiative which is a national program that will provide financing for the Canadian aerospace sector emerging from the pandemic and continue to compete on the global stage. Companies will be eligible to apply for funding of projects that will help them green their operations and adopt environmentally sustainable practices, improve productivity and strengthen commercialization, support digital adoption and enhanced cybersecurity, improve diversity and inclusion to address barriers faced by certain groups, and strengthen integration into regional and global supply chains.

Customer Contracts

The Company is exposed to the risk that existing customer fixed-term contracts are not renewed at the expiration date. Avcorp Group operates within "general terms agreements" with its customers. These typically have a duration of five or more years. The Company's agreements with Boeing Commercial Airplanes extend from current date, with various expiry timelines, through to the end of 2027 with options to 2029. Agreements with Boeing Defence, Space & Security extend into 2022 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 Systems and Lockheed Martin customer contracts extend into 2022. The Company is currently negotiating the extension of follow-on contracts into 2026.

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, 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 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 and ensure uninterrupted delivery of compliant products with a cost structure closely matching product pricing. Forecast changes are closely monitored so that prompt adjustments can be made to material and parts procurement with the objective of limiting unwanted inventory build-up.

Aircraft Production Rates

The following industry and program trends impact the Company:

- The aerostructures markets for commercial aircraft and larger business jets is expected to recover by 2023.
- Boeing has resumed production of the 737 MAX with low rate production in 2021 with a gradual increase in early 2022.
- Bombardier Challenger CL650 aircraft production requirements are higher in 2021 compared to 2020, production requirements are projected to increase over the next 5 years.
- The global market for defence aircraft is expected to continue to grow.

- 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 Fixed Wing Search and Rescue could lead to additional revenue opportunities from this aerospace sector.
- The COVID-19 virus has adversely impacted the aviation industry. The pandemic drastically reduced passenger airline traffic. The OEMs have reduced their production rates with anticipated full recoveries in late 2022 to early 2023.

Competitors

The long-term trend continues towards more intense competition from larger entities having operations in Asia, Mexico, and Europe, while OEMs continue to increase the size and quantity 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 enhance vertical strengths or additional strategic capabilities.

Cost Reductions

Approximately 59% of Avcorp Group's cost of sales is related to labour and overhead and 41% is related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its western European and northwestern United States competitors and higher than those in the southeastern United States, Asia, Eastern Europe, and Mexico. On September 25, 2019, the Company reached a labour agreement with the International Association of Machinists and Aerospace Workers (Lodge 250) (the "Union") at its Delta, British Columbia facility. The six-year labour agreement was ratified by the Union and will expire on March 31, 2025. 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

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.

The Company carries US dollar denominated debt within Bank Indebtedness, Term Debt, and Accounts Payable. If the Canadian dollar weakens against the US Dollar, the Company will have a foreign exchange loss and if the Canadian dollar strengthens against the US dollar, the Company will have a foreign exchange gain. The impact of this will be mitigated by US dollar denominated cash, accounts receivable, and contract assets.

Outlook

The Company is positioned to perform well in 2022 and into the longer term. Longer term performance, based on current expectations of contracts and contract renewals, show a growth plan with positive operational performance and significant improvement in net cash from operating activities that will enable the Company to repay any outstanding bank indebtedness by fiscal year 2026. The Company continues to work toward securing new defence and commercial program production contracts to augment and diversify its backlog and renewing existing customer production contracts. Current contracts extend as far as 2027 and beyond. As the demand for the commercial air traffic improves and original equipment manufacturer ("OEM") production rates increase for both commercial and defense programs, the Company is expecting a 20% annual growth in revenue in the coming couple of years. We have strong order backlog as at December 31, 2021 of \$457 million.

There continues to be positive signs of market recovery and returning air travel into 2022 onward as we emerge from the COVID-19 pandemic. The Company has implemented a number of measures to align its cost structure to demand and maximize cash preservation during these market conditions which will benefit the Company as it emerges from the current crisis on solid footing.

The Delta and Burlington facility performance is expected to improve as the commercial customer delivery requirements recover into 2022 and onward from the COVID-19 Pandemic. At the Gardena facility, management is navigating through changing customer requirements and will continue to rebalance the labour force accordingly, enforce stringent cost cutting measures and consolidate its footprint. Boeing suspended deliveries of its 787 aircraft during 2021 which continues to impact Subaru's delivery requirement from the Gardena facility. Avcorp is working closely with Subaru to ensure a continued steady rate of supply in the short-term and expect a recovery of the production rate in the long term. The Company is actively seeking new production contracts with customers such as Space Exploration Technologies Corp. and SpinLaunch inc. out of the Gardena facility.

On March 12, 2021, the Company entered into a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V. This eliminated a future guarantee fees payable to the customer significantly reducing financing costs annually.

The Company forecasts its working capital requirements during the growth path will be met by the current operating line of credit, working capital surplus, and availability on a shareholder loan.

Going Concern

Management assesses the Company's ability to continue as a going concern at each reporting date, using 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, such as, the Company's ability to achieve improvements in operating results and mitigate the adverse impact of the COVID-19 virus. In assessing whether the going concern assumption was appropriate, management considered all relevant information available about the future, which is the 12-month period from the date of this report. 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 assessment of the Company's ability to execute its strategy of reducing operating costs and ability to mitigate the risk of the COVID-19 virus involves significant judgement. Estimates and assumptions regarding future revenue and related profitability 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.

The Company, in conjunction with its Board of Directors, has implemented various financing strategies to mitigate this risk. The Company has raised on March 12, 2021, by way of a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V., a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate undrawn availability of USD \$13,000,000. In addition, as at December 31, 2021 the Company had a cash balance of \$4,060,000 (December 31, 2020 \$7,044,000) and ability to draw up to an additional \$7,879,000 (USD \$6,215,000) on its operating line of credit.

Management will continue to evaluate the operations of the company to improve profitability and will continue to work with its current lender, an existing common shareholder and other parties to seek additional financing if necessary. The Company cannot provide assurance that it will achieve profitability or that, if it needs to raise additional funds, such funds will be available on favorable terms, or at all. If the Company cannot achieve profitability or raise adequate funds on acceptable terms, its business could be materially harmed.

In March 2020, the World Health Organization ("WHO") declared the COVID-19 virus a global pandemic. The ongoing COVID-19 pandemic, including the emergence of new variants, continues to negatively impact the global economy, global supply chains, the aviation industry particularly in the commercial airline industry, and create economic uncertainty. Governments worldwide have enacted emergency measures including travel bans, social distancing measures and mandatory quarantine requirements. Avcorp's operations in 2020 and 2021 at varying times have been challenged with reduced production driven by customers' build rate adjustments, government related enacted measures to modify work practices to meet health and safety standards, and related supply chain issues.

There continues to be positive signs of market recovery and recovering air travel into 2022. The Company will continue to implement measures to align its cost structure and maximize cash preservation during the current market conditions to ensure it emerges from the current crisis on solid footing. The situation remains dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company remains unknown at this time.

Transactions with Related Parties

Periodically, consulting services are provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the year ended December 31, 2021, amount to \$Nil (December 31, 2020: \$Nil). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2021, are \$Nil (December 31, 2020: \$Nil). These fees are included in the consolidated statements of loss and comprehensive loss as administrative and general expenses and amount to \$Nil for the year ended December 31, 2021, (December 31, 2020: \$Nil).

Key management includes members of the Board of Directors of the Company and executive officers for all operating facilities, as they have the collective authority for and responsibility of planning, directing, and controlling the activities of the Company. The compensation expense for key management for services is shown below:

KEY MANAGEMENT COMPENSATION

(expressed in thousands of Canadian dollars)

	2021	2020
Salaries and other short-term employee benefits	\$2,672	\$1,867
Contributions to defined contribution plan	97	91
Option-based awards	1,357	32
	4,126	1,990

The balance of loans receivable from key management as at December 31, 2021, is \$5,000 (December 31, 2020: \$5,000). These loans are unsecured and payable on demand.

Other related party transactions are disclosed elsewhere in these consolidated financial statements.

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

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 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 of the Company's CGU. 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.

During the year the Company determined that the equipment, the right-of-use assets and intangible assets of its ACF cash generating unit were impaired. The equipment were written down to its recoverable amount of \$5,509,000 (USD \$4,345,000). The fair value less cost to sell of the equipment was determined by an independent appraiser using sales of comparable equipment or a cost approach. The main inputs were estimate of value based on recent sales of comparable equipment and estimates of the impact of physical deterioration, functional or technological obsolescence and external or economic obsolescence for value derived from using a cost approach. Management estimated that no value can be generated out of the right-of-use assets upon a sale or sublease, their fair value less cost of sell was estimated to be nil as at the end of the year.

- **Going concern and debt classification:** Management assesses the Company's ability to continue as a going concern at each reporting date, using 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.
- **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.

On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed \$10,112,000 of overhead costs during the current year (December 31, 2020: \$8,346,000) in respect of unutilized plant capacity. These amounts are included in the Consolidated Statements of 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. 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 total onerous contract provision for the year ended December 31, 2021 is \$1,864,000 (December 31, 2020: \$565,000).
- The values of right of use assets and lease liabilities require judgement in determining lease terms such as extension option and discount rate used. In the case where incremental borrowing rate is used, the Company estimates the incremental borrowing rate based on the lease term, collateral assumptions, and the economic environment in which the lease is denominated.

- Upon termination for convenience for customer contracts subject to the Federal Acquisition Regulation ("FAR"), the Company must assess the contractual provisions that permit termination and the related contractual remedies available to recover all or a portion of our incurred costs and fees for work performed. Variable consideration is recognized as estimated revenue to the extent it is probable that a significant reversal in the amount of revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Management estimated the variable consideration using actual costs, an estimate of reasonable profit margin determined in accordance with the contractual provisions and historical experience, and delay cost estimated under the contractual entitlement subject to FAR. Although the Company believes its estimates and assumptions made are consistent with the terms and conditions of the contract, the actual settlement amount determined at a future date could materially affect the Company's reported financial results.
- The Company has determined that it will meet the eligibility requirements for forgiveness of the second wave U.S. Small Business Administration Paycheck Protection Program loan and has recognized \$2,513,000 (USD \$2,004,000) in other income in the current year.

Financial Instruments and Other Instruments

Market Risk

Market risk arises as a consequence of the fact 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 gain recorded for the year ended December 31, 2021 is \$295,000 (December 31, 2020: \$364,000 loss).

The Company had the following US dollar denominated balances:

CURRENCY RISK

(expressed in thousands of dollars)

AS AT DECEMBER 31

	2021 (expressed in USD)	2020 (expressed in USD)
Bank cash position	\$2,568	\$3,285
Accounts receivable	9,849	6,393
Accounts payable	5,843	3,726
Customer advance	-	4,643
Bank indebtedness	59,421	60,037
Term debt	11,143	10,322

With other variables unchanged, each \$0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately \$6,399,000 in net income for the year ended December 31, 2021, as a result of holding a net liability position in USD as at December 31, 2021.

As at December 31, 2020, a \$0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately \$6,905,000 in net income for the year ended December 31, 2020 as a result of holding a net liability position in USD as at December 31, 2020.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. 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 Defence, 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 88.0% (December 31, 2020: 89.6%) 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 OEM and Tier 1 aerospace customer base as at December 31, 2021. 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.

The Company has a working capital surplus of \$7,613,000 as at December 31, 2021, compared with \$77,780,000 deficit as at December 31, 2020. Working capital is defined as the difference between current assets and current liabilities. The increase compared to 2020 was mainly due to the bank indebtedness re-classified as non-current upon extension of maturity to June 30, 2023. On December 31, 2021, the ratio of the Company's current assets to current liabilities was 1.18:1 (December 31, 2020: 0.47:1). The Company's accounts receivable, government grant receivable, current contract assets, and inventories net of current accounts payable amount to a \$24,452,000 surplus as at December 31, 2021, (December 31, 2020: \$33,174,000 surplus).

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

Management assesses the Company's ability to continue as a going concern at each reporting date, using 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, such as, the Company's ability to achieve improvements in operating results and mitigate the adverse impact of the COVID-19 virus. In assessing whether the going concern assumption was appropriate, management considered all relevant information available about the future, which is the 12-month period from the date of this report. 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 assessment of the Company's ability to execute its strategy of reducing operating costs and ability to mitigate the risk of the COVID-19 virus involves significant judgement. Estimates and assumptions regarding future revenue and related profitability 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.

The Company, in conjunction with its Board of Directors, has implemented various financing strategies to mitigate this risk. The Company has raised on March 12, 2021, by way of a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V., a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate undrawn availability of USD \$13,000,000. In addition, as at December 31, 2021 the Company had a cash balance of \$4,060,000 (December 31, 2020 \$7,044,000) and ability to draw up to an additional \$7,879,000 (USD \$6,215,000) on its operating line of credit.

Management will continue to evaluate the operations of the company to improve profitability and will continue to work with its current lender, an existing common shareholder and other parties to seek additional financing if necessary. The Company cannot provide assurance that it will achieve profitability or that, if it needs to raise additional funds, such funds will be available on favorable terms, or at all. If the Company cannot achieve profitability or 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 of USD\$23,000,000 revolving loan less USD\$1,000,000:

- Royal Bank Prime ("RBP") plus 1.50% per annum
- Royal Bank US Base Rate ("RBUSTR") plus 1.50% per annum
- Banker's Acceptance ("BA") Equivalent Rate plus 3.00% per annum
- LIBOR Rate plus 3.00% per annum

The utilized portion of this operating line of credit at year end amounting to \$18,303,000 (USD \$14,437,000).

Interest rate for advances made on the additional USD\$45,000,000 borrowing capacity up to USD\$68,000,000.

- 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

The utilized portion of this operating line of credit at year end amounting to \$57,032,000 (USD \$44,984,000).

The LIBOR has been subject to recent proposed reforms. The LIBOR will be phased out by June 30, 2023 which is consistent to the term of the loan agreement. The consequences of these developments cannot be predicted with certainty, however, no significant impact is expected.

Drawdown under the USD\$45,000,000 additional borrowing capacity is supported by a Guarantee provided by a Guarantor. Panta Holdings B.V. provided guarantee to the Guarantor in the maximum payment of USD\$10,000,000 if the bank draws on the Guarantee in whole or in part. The Company provided 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). On March 12, 2021, the Company has amended and restated the accommodation agreement with the Guarantor and Panta B.V. Canada waiving all rights to the Guarantee Fee.

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, to meet short term obligations and to provide an adequate return to shareholders, while satisfying other stakeholders.

The Company includes long-term debt 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.

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 ("CEO") and the Vice President, Finance ("VP Finance") that, among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting. These certificates can be found on www.sedar.com.

The Company has continued to undertake to engage additional, qualified, financial reporting expertise and tax accounting resources to assist with complex accounting matters, as well as develop the expertise of in-house staff. 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 CEO and the VP Finance have designed internal controls over financial reporting or have caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

An evaluation was carried out, under the supervision of the CEO and the VP Finance, of the design and effectiveness of our internal controls over financial reporting. Based on this evaluation, the CEO and the VP Finance concluded that the internal controls over financial reporting are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework (2013 Framework).

Disclosure Controls and Procedures ("DCP")

The CEO and the VP Finance have designed disclosure controls and procedures, or have caused them to be designed under their supervision, to provide reasonable assurance that:

- material information relating to the Corporation has been made known to them; and
- information required to be disclosed in the Corporation's filings is recorded, processed, summarized, and reported within the time periods specified in securities legislation.

An evaluation was carried out, under the supervision of the CEO and the VP Finance, of the design and effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the VP Finance concluded that the disclosure controls and procedures are effective.

Forward Looking Statements Disclaimer

This MD&A includes forward-looking statements, which may involve, but are not limited to: statements with respect to our business objectives, prospects, and guidance in respect of various financial and industry metrics, including, goals, strategies, capabilities, market position, competitive strengths, prospects, plans, expectations, anticipations, estimates and intentions; business and economic, industry trends; customer demand for products; order backlog mix; the regulatory environment and legal proceedings; strength of our balance sheet, creditworthiness, capital resources, anticipated financial requirements, productivity enhancements, operational efficiencies, cost reduction and the intended benefits and timing thereof; availability of government assistance programs, compliance with debt covenants; and the impact of the COVID-19 pandemic on the foregoing; expectations regarding gradual market and economic recovery in the aftermath of the COVID-19 pandemic.

Forward-looking statements can generally be identified by the use of forward-looking terminology such as “may”, “will”, “shall”, “can”, “expect”, “estimate”, “intend”, “anticipate”, “plan”, “forecast”, “foresee”, “believe”, “continue”, “maintain” or “align”, the negative of these terms, variations of them or similar terminology.

Forward-looking statements are presented for the purpose of assisting investors and others in understanding certain key elements of our current objectives, strategic priorities, expectations, outlook, and plans, and to obtain an understanding of our business and anticipated operating environment. Readers are cautioned that such information may not be appropriate for other purposes.

Forward-looking statements require management and the Board to make assumptions and are subject to and unknown risks and uncertainties, which may cause our actual results in future periods to differ materially from forecast results set forth in forward-looking statements. While management and the Board consider these assumptions to be reasonable and appropriate based on information currently available, there is risk that they may not be accurate. The assumptions underlying the forward-looking statements made in this MD&A in relation to the five-year forecast include the following material assumptions: the award and fulfilment of customer contracts that the Company does not currently have in its backlog, the continuation of existing customer programs and anticipated labour costs associated with our operations for the periods covered in the forecast. Additional information, including with respect to other assumptions and risk factors underlying the forward-looking statements made in this MD&A, refer to the risk factors in both our Annual Report and our Annual Information Form for the fiscal year ended December 31, 2021. Given the impact of the changing circumstances surrounding the COVID-19 pandemic, there is inherently more uncertainty associated with the Corporation’s assumptions as compared to prior years.

Certain factors that could cause actual results to differ materially from those anticipated in the forward-looking statements include, but are not limited to, risks associated with overall global and domestic economic conditions, risks associated with our business environment (such as risks associated with the financial condition of our customers; increased competition from international and domestic suppliers; force majeure events), operational risks such as the award of new business; order backlog; the execution of customer orders; cash flows and capital expenditures based on cyclicity; productivity enhancements, operational efficiencies, cost reduction initiatives; product warranty; regulatory and legal proceedings; environmental, health and safety risks; dependence on certain customers, contracts and suppliers; supply chain risks; human resources; reliance on information systems; reliance on and protection of intellectual property rights; adequacy of insurance coverage), financing risks (such as risks related to liquidity and access to capital markets; substantial debt and interest payment requirements; debt covenants), market risks (such as foreign currency fluctuations; changing interest rates; increases in commodity prices; and inflation rate fluctuations). For more details, see the Risks outlined in our MD&A. The foregoing factors may be exacerbated by the ongoing COVID-19 outbreak and may have a significantly more severe impact on the Corporation’s business, results of operations and financial condition than in the absence of such outbreak. As a result of the current COVID-19 pandemic, additional factors that could cause actual results to differ materially from those anticipated in the forward-looking statements include, but are not limited to: risks related to the impact and effects of the COVID-19 pandemic on economic conditions and financial markets and the resulting impact on our business, operations, capital resources, liquidity, financial condition, margins, prospects and results; uncertainty regarding the magnitude and length of economic disruption as a result of the COVID-19 outbreak and the resulting effects on the demand for our products and services; emergency measures and restrictions imposed by public health authorities or governments, fiscal and monetary policy responses by governments and financial institutions; disruptions to global supply chain, customers, workforce, counterparties and third-party service providers; further disruptions to operations, orders and deliveries; technology, privacy, cyber security and reputational risks; and other unforeseen adverse events.

The forward-looking statements present certain non-IFRS financial measures to assist readers in understanding the Company’s forecasted performance. Non-IFRS financial measures are measures that either exclude or include amounts that are not excluded or included in the most directly comparable measures calculated and presented in accordance with Generally Accepted Accounting Principles (“GAAP”).

The foregoing list of factors that may affect future results and performance is not exhaustive and undue reliance should not be placed on forward-looking statements. The forward-looking statements set forth herein reflect management’s expectations as at the date of this MD&A and are subject to change after such date. Unless otherwise required by applicable securities laws, we expressly disclaim any intention, and assume no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

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 and has been reviewed and approved by the Board of Directors of the Company. The Board of Directors is responsible for ensuring that we fulfill our responsibilities for financial reporting and is ultimately responsible for reviewing and approving the MD&A. The Board of Directors carries out this responsibility principally through its Audit Committee. The Audit Committee is appointed by the Board of Directors and is comprised entirely of independent directors. The Audit Committee reports its findings to the Board of Directors for its consideration when it approves the MD&A and financial statements for issuance to shareholders. 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, 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. As at the end of the period covered by this report, the system of internal control provides reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with IFRS. During the period covered by this report, there has been no change in internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

<i>"Amandeep Kaler"</i>	AMANDEEP KALER Executive Officer and Group Chief Executive Officer	<i>"Amish Patel"</i>	AMISH PATEL Group Vice President, Finance
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Independent auditor's report

To the Shareholders of
Avcorp Industries Inc.

Opinion

We have audited the consolidated financial statements of **Avcorp Industries Inc.** and its subsidiaries [the "Group"], which comprise the consolidated statements of financial position as at December 31, 2021 and 2020, and the consolidated statements of loss and comprehensive loss, consolidated statements of changes in shareholders' deficiency and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects the consolidated financial position of the Group as at December 31, 2021 and 2020, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ["IFRSs"].

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditors' responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material uncertainty related to going concern

We draw attention to note 1 in the consolidated financial statements, which indicates that the Group had a net loss of \$531,000, operating cash flows of \$4,902,000, shareholders' deficiency of \$48,107,000, and an accumulated deficit of \$149,450,000. These events or conditions, along with other matters as set forth in note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the consolidated financial statements of the current period. In addition to the matters described in the Material Uncertainty Related to Going Concern section, we have determined the matters described below to be the key audit matters to be communicated in our report. These matters were addressed in the context of the audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.



Key audit matter	How our audit addressed the key audit matter
<i>Valuation of equipment of Avcorp Composite Fabrication (ACF) cash-generating unit ("CGU")</i> As disclosed in note 14, the Company recognized an impairment loss of \$7,815,000 related to its ACF CGU, which included \$7,216,000 related to equipment of the CGU. The equipment has been impaired to its recoverable amount of \$5,509,000, determined using a fair value less costs to sell ["FVLCS"] approach based on estimates of fair value from an external appraiser [management's specialist] using a market or cost approach, as appropriate. Auditing the recoverable amount of the equipment was a key audit matter because due to the specialized nature of most of the equipment of the CGU, determining the FVLCS involves significant judgement in determining the appropriate methodologies and assumptions such as developing an estimate of value based on recent sales of comparable equipment and estimating the impact of physical deterioration, functional/technological obsolescence and external or economic obsolescence for value derived from using a cost approach. Key assumptions are affected by expectations about future market and economic conditions, which include the uncertainty of demand for the equipment of the CGU resulting from the impact of COVID-19 on the industry both globally and locally. Changes in these assumptions can have a material effect on the determination of the recoverable amount.	
	Our audit procedures included, among others, the following to address the key assumptions mentioned above: • Assessing the competence, objectivity and independence of management's specialist • Involving valuation specialists to assist in evaluating the methodologies and assumptions used to determine the FVLCS of the equipment

Key audit matter	How our audit addressed the key audit matter
<i>Valuation of variable consideration to be recognised in Revenue related to contract terminations</i>	
As at December 31, 2021 the Company reported a Contract Asset balance of \$31,398,000 which includes variable consideration related to certain contracts with a customer which were terminated for the convenience of the U.S. government under the Federal Acquisition Regulation ["FAR"]. The regulation along with the terms within the Company's contracts allow for the Company to claim certain costs incurred associated with the contracts plus a reasonable profit margin upon termination. The determination of the variable consideration requires significant judgement and estimation. The amount of variable consideration is based on the actual costs, reasonable profit margin and delay cost estimated under the contractual entitlement subject to FAR. The Company has recognised variable consideration in revenue to the extent that it is highly probable that a significant reversal will not occur when the uncertainty related to the amount is resolved. The Company's policy related to variable consideration is described in notes 3 and 4 to the consolidated financial statements. We identified the valuation of variable consideration to be a key audit matter because it involves significant judgement by management in determining the constrained estimated value of the various key inputs involved such as actual costs incurred, a reasonable profit margin and the delay cost estimated.	Our audit procedures included the following, among others, to address the judgements and inputs to the estimate: • We obtained an understanding of management's process to update their estimate of variable consideration through inquiries with management and program manager. • We evaluated the appropriateness of changes, or lack thereof, in estimated variable consideration by obtaining and inspecting communications between the Company, its customer and the government bodies regarding the settlement negotiations and evaluating their impact on key inputs including delay costs, labour and overhead hours, FAR rates, and reasonable profit margin.

Other information

Management is responsible for the other information. The other information comprises:

Management's Discussion and Analysis

The information, other than the consolidated financial statements and our auditor's' report thereon, in the Annual Report

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements, or whether our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis and the Annual Report prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated to those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Nicole Poirier.

Vancouver, Canada
March 24, 2022

Ernst & Young LLP

Chartered Professional Accountants



CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(expressed in thousands of Canadian dollars)

AS AT DECEMBER 31

ASSETS

Current assets

Cash (note 16)	\$4,060	\$7,044
Accounts receivable (note 9)	18,116	14,436
Government grant receivable (note 27)	-	2,688
Contract assets (note 10)	13,319	34,325
Inventories (note 11)	12,809	9,657
Prepayments and other assets (note 12)	2,091	2,108

Non-current assets

Prepayments and other assets (note 12)	2,868	2,877
Development costs (note 13)	10,597	9,045
Contract assets (note 10)	18,079	-
Property, plant, and equipment (note 14)	20,698	38,703
Intangibles (note 15)	-	655

Total assets

102,637	121,538
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LIABILITIES AND DEFICIENCY

Current liabilities

Bank indebtedness (note 16)	-	76,708
Accounts payable and accrued liabilities (note 18 and 24)	19,792	27,932
Term debt (note 20)	3,041	16,868
Contract liability (note 19)	18,625	11,502
Onerous contract provision (note 21)	1,324	282
Deferred government grant (note 27)	-	657
Customer advance (note 17 and 24)	-	5,911
Guarantee fee (note 16 and 24)	-	8,178

Non-current liabilities

Bank indebtedness (note 16)	74,412	-
Term debt (note 20)	26,156	19,168
Contract liability (note 19)	4,843	3,189
Accounts payable and accrued liabilities (note 18)	2,011	-
Onerous contract provision (note 21)	540	283

(Deficiency) Equity

Capital stock (note 23)	86,456	86,219
Contributed surplus	6,742	5,478
Accumulated other comprehensive income	8,145	8,082
Accumulated deficit	(149,450)	(148,919)

Total liabilities and deficiency

102,637	121,538
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Nature of operations and going concern (note 1). The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors on March 24, 2022.

"David Levi"

David Levi
Chairman

"Ken Robertson"

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)*

	2021	2020
FOR THE YEAR ENDED DECEMBER 31		
Revenues (notes 33)	\$99,476	\$150,962
Cost of sales (notes 11, 21 and 33)	99,546	142,729
Gross (loss) profit	(70)	8,233
Administrative and general expenses	18,277	16,717
Office equipment depreciation	723	787
Accommodation agreement settlement (note 24)	(21,391)	-
Impairment loss (note 14, 15)	7,815	-
Other income (note 27)	(8,180)	(11,642)
Operating income	2,686	2,371
Finance costs – net (note 28)	3,091	7,605
Foreign exchange (gain) loss	(295)	364
Net loss on sale and write-off of equipment	421	1,127
Loss before income tax	(531)	(6,725)
Income tax expense	-	-
Loss for the year	(531)	(6,725)
Other comprehensive income	63	1,028
Total comprehensive loss for the year	(468)	(5,697)
Loss per share:		
Basic loss per common share (note 32)	(0.00)	(0.02)
Diluted loss per common share (note 32)	(0.00)	(0.02)
Basic weighted average number of shares outstanding (000's) (note 32)	368,257	368,118
Diluted weighted average number of shares outstanding (000's) (note 32)	368,257	368,118

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

CONSOLIDATED STATEMENTS OF CASH FLOWS*(expressed in thousands of Canadian dollars)***FOR THE YEAR ENDED DECEMBER 31****Cash flows from operating activities**

	2021	2020
Net loss for the year	\$(531)	\$(6,725)
Adjustment for items not affecting cash:		
Net interest expense	3,091	7,605
Depreciation	7,147	8,338
Development cost amortization	1,404	8,955
Intangible assets amortization	91	1,197
Loss on disposal of equipment	421	1,127
Provision for onerous contracts	1,299	308
Stock based compensation	1,389	32
Provision for obsolete inventory	2,030	(163)
Provision for doubtful accounts	4	(326)
Unrealized foreign exchange	(235)	(694)
Government grant income	(3,437)	(6,632)
Accommodation agreement settlement	(21,391)	-
Impairment Loss	7,815	-
Loss on lease modification	204	-
Cash (used in) flows from operating activities before changes in non-cash working capital	(699)	13,022
Changes in non-cash working capital		
Accounts receivable	5,536	9,195
Contract assets	2,879	(8,270)
Inventories	(5,157)	3,397
Prepayments and other assets	2,850	13
Accounts payable and accrued liabilities	894	(10,265)
Deferred government grant	(657)	-
Contract liability	(743)	2,033
Net cash from operating activities	4,903	9,125
Cash flows used in investing activities		
Proceeds from sale of equipment	852	61
Purchase of equipment	(2,221)	(1,769)
Payments relating to development costs and tooling	(2,956)	(3,929)
Receipt of government grants for purchase of equipment	147	-
Initial lease payments and other direct costs incurred	-	(31)
Net cash used in investing activities	(4,178)	(5,668)
Cash flows used in financing activities		
Proceeds from bank indebtedness	1,266	653
Repayment of bank indebtedness	(2,105)	(7,368)
Payment of interest	(2,441)	(3,954)
Proceeds from term debt	2,508	12,453
Repayment of term debt	(3,047)	(2,524)
Proceeds from Issuance of Common Shares	112	-
Net cash used in financing activities	(3,707)	(740)
Net (decrease) increase in cash	(2,982)	2,717
Net foreign exchange difference	(2)	11
Cash - Beginning of the year	7,044	4,316
Cash - End of the year	4,060	7,044

Supplementary Cash Flow Information (note 29).

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' DEFICIENCY*(expressed in thousands of Canadian dollars, except number of shares)*

	Capital Stock		Contributed Surplus	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Deficiency
	Number of Shares	Amount				
Balance at December 31, 2019	368,118,620	86,219	5,446	(142,194)	7,054	(43,475)
Stock-based compensation expense	-	-	32	-	-	32
Unrealized currency gain on translation for the period	-	-	-	-	1,028	1,028
Net loss for the period	-	-	-	(6,725)	-	(6,725)
Balance at December 31 2020	368,118,620	86,219	5,478	(148,919)	8,082	(49,140)
Balance at December 31, 2020	368,118,620	86,219	5,478	(148,919)	8,082	(49,140)
Issue of Common Shares	2,812,500	112	-	-	-	112
Transfer to share capital on exercise of stock options	-	125	(125)	-	-	-
Stock-based compensation expense	-	-	1,389	-	-	1,389
Unrealized currency gain on translation for the period	-	-	-	-	63	63
Net loss for the period	-	-	-	(531)	-	(531)
Balance at December 31, 2021	370,931,120	86,456	6,742	(149,450)	8,145	(48,107)

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, there exist 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, 2021, were authorized for issue in accordance with a resolution of its Board of Directors on March 24, 2022.

During the year ended December 31, 2021, the Company had a net loss of \$531,000 (December 31, 2020: net loss of \$6,725,000), had positive operating cash flows of \$4,903,000 (December 31, 2020: positive \$9,125,000) shareholders' deficiency of \$48,107,000 as of December 31, 2021 (December 31, 2020: \$49,140,000 deficiency) and an accumulated deficit of \$149,450,000 (December 31, 2020: \$148,919,000).

Management assesses the Company's ability to continue as a going concern at each reporting date, using 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, such as, the Company's ability to achieve improvements in operating results and mitigate the adverse impact of the COVID-19 virus. In assessing whether the going concern assumption was appropriate, management considered all relevant information available about the future, which is for at least the 12-month period from the date of this report. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes could materially impact the validity of such an assessment.

The assessment of the Company's ability to execute its strategy of reducing operating costs and ability to mitigate the risk of the COVID-19 virus involves significant judgement. Estimates and assumptions regarding future revenue and related profitability 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.

The Company, in conjunction with its Board of Directors, has implemented various financing strategies to mitigate this risk. The Company has secured on March 12, 2021, by way of a multiparty amended and restated Accommodation Agreement with a customer and Panta Canada B.V., a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate undrawn availability of USD \$13,000,000. In addition, as at December 31, 2021 the Company had a cash balance of \$4,060,000 (December 31, 2020 \$7,044,000) and ability to draw up to an additional \$7,879,000 (USD \$6,215,000) on its operating line of credit.

Management will continue to evaluate the operations of the company to improve profitability and will continue to work with its current lender, an existing common shareholder and other parties to seek additional financing if necessary. The Company cannot provide assurance that it will achieve profitability or that, if it needs to raise additional funds, such funds will be available on favorable terms, or at all. If the Company cannot achieve profitability or raise adequate funds on acceptable terms, its business could be materially harmed.

Impact of COVID-19

In March 2020, the World Health Organization ("WHO") declared the COVID-19 virus a global pandemic. The ongoing COVID-19 pandemic, including the emergence of new variants, continues to negatively impact the global economy, global supply chains, the aviation industry particularly in the commercial airline industry, and create economic uncertainty. Governments worldwide have enacted emergency measures including travel bans, social distancing measures and mandatory quarantine requirements. Avcorp's operations in 2020 and 2021 at varying times have been challenged with reduced production driven by customers' build rate adjustments, government related enacted measures to modify work practices to meet health and safety standards, and supply chain issues.

There continues to be positive signs of market recovery and recovering air travel into 2022. The Company will continue to implement measures to align its cost structure and maximize cash preservation during the current market conditions to ensure it emerges from the current crisis on solid footing. The situation remains dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on the Company remains unknown at this time.

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.

Accounting standards issued but not yet effective

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

Amendments to IAS 1: Classification of Liabilities as Current or Non-Current

In January 2020, the IASB issued Classification of Liabilities as Current or Non-current (Amendments to IAS 1). The amendments aim to promote consistency in applying the requirements by helping companies determine whether, in the statement of financial position, debt and other liabilities with an uncertain settlement date should be classified as current (due or potentially due to be settled within one year) or non-current. The amendments include clarifying the classification requirements for debt a company might settle by converting it into equity. The amendments are effective for annual reporting periods beginning on or after January 1, 2023, with earlier application permitted. The Company is currently assessing the impact and the timing to adopt this amendment.

Amendments to IAS 37: Onerous Contracts – Costs of Fulfilling a contract

In May 2020, the IASB issued amendments to IAS 37 to specify which costs an entity needs to include when assessing whether a contract is onerous or loss-making.

The amendments apply a "directly related cost approach". The costs that relate directly to a contract to provide goods or services include both incremental costs and an allocation of costs directly related to contract activities. General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract.

The amendments are effective for annual reporting periods beginning on or after January 1, 2022, with earlier application permitted. The Company will apply these amendments to contracts for which it has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments. The Company presently applies a "directly related cost approach" to assess whether a contract is onerous and does not expect the adoption to have a significant impact on the Company's consolidated financial statements.

Amendments to IAS 8: Definition of Accounting Estimates

In February 2021, the IASB issued amendments to IAS 8, in which it introduces a definition of 'accounting estimates'. The amendments clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors. Also, they clarify how entities use measurement techniques and inputs to develop accounting estimates.

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and apply to changes in accounting policies and changes in accounting estimates that occur on or after the start of that period. Earlier application is permitted as long as this fact is disclosed.

The Company is currently assessing the impact of the amendments on current practice.

Amendments to IAS 1 and IFRS Practice Statement 2: Disclosure of Accounting Policies

In February 2021, the IASB issued amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements, in which it provides guidance and examples to help entities apply materiality judgements to accounting policy disclosures. The amendments aim to help entities provide accounting policy disclosures that are more useful by replacing the requirement for entities to disclose their 'significant' accounting policies with a requirement to disclose their 'material' accounting policies and adding guidance on how entities apply the concept of materiality in making decisions about accounting policy disclosures.

The amendments to IAS 1 are applicable for annual periods beginning on or after 1 January 2023 with earlier application permitted. Since the amendments to the Practice Statement 2 provide non-mandatory guidance on the application of the definition of material to accounting policy information, an effective date for these amendments is not necessary.

The Company is currently assessing the impact of the amendments to determine the impact they will have on the Company's accounting policy disclosures.

3. Significant Accounting Policies

The significant accounting policies and methods of computation used in the preparation of these consolidated financial statements are described below. The 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, 2021. 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.

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 subsidiaries, 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 statements 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 statements of loss.

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.

Financial instruments**a) Financial assets**

Financial assets include, in particular, cash and accounts receivables.

Financial assets are classified, at initial recognition, as subsequently measured at amortized cost, fair value through other comprehensive income, or fair value through profit or loss. The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics. With the exception of accounts receivables that do not contain a significant financing component or for which the Company has applied the practical expedient, the Company initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

Accounts receivables that do not contain a significant financing component or for which the Company has applied the practical expedient are measured at the transaction price determined under IFRS 15. Refer to the accounting policies for Revenue from contracts with customers.

The Company measures financial assets at amortized cost if the financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Financial assets at amortized cost are subsequently measured using the effective interest method and are subject to impairment. Gains and losses are recognized in the consolidated statement of loss when the asset is derecognized, modified or impaired.

The Company's financial assets at amortized cost includes accounts receivables.

The Company recognizes an allowance for expected credit losses (ECLs) for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive, discounted at an approximation of the original effective interest rate. The expected cash flows will include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. For accounts receivables and contract assets, the Company applies a simplified approach in calculating ECLs. Therefore, the Company does not track changes in credit risk, but instead recognizes a loss allowance based on lifetime ECLs at each reporting date.

The Company has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. The provision for ECL rates is based on days past due for groupings of various customer segments that have similar loss patterns (i.e., by customer type and rating). The amount of ECLs is sensitive to changes in circumstances and of forecast economic conditions. The Company's historical credit loss experience and forecast of economic conditions may also not be representative of customer's actual default in the future.

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 the bank indebtedness, accounts payables, finance lease liabilities, customer advance, guarantee fee, 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 based on market interest rate for a similar financial liability. The financial liability initially recognized at fair value is amortized subsequent to initial recognition using the effective interest method.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statement of loss.

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.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021***(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)***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 the consolidated statement of 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 and impairment expense on intangible assets with finite lives is recognized in the consolidated statement of 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.

Impairment losses of continuing operations are recognized in the consolidated statement of loss separately.

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 consolidated statement of 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 vesting period ranges from immediately 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.

Revenue

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.

Revenue is recognized either at a point in time or over time, as the Company satisfies performance obligations by transferring the promised goods or services to its customers. An asset is transferred as the customer obtains control of the asset. If a performance obligation is not satisfied over time, the Company satisfies the performance obligation at a point in time when the goods are delivered to customers.

The Company transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if one of the following criteria is met:

- the customer simultaneously receives and consumes the benefits provided by the Company's performance as the Company performs;
- the Company's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
- the Company's performance does not create an asset with an alternative use to the Company and the Company has an enforceable right to payment for performance completed to date.

The Company transfers control of the goods over time as evidenced either by contractual termination clauses or by our rights to payment for work performed to date plus a reasonable profit to deliver products that do not have an alternative use to the Company. The Company uses the input method to measure the satisfaction of performance obligations over time. The inputs are labour hours expended and cost of materials consumed relative to the total expected inputs to the satisfaction of that performance obligation.

Determining whether a contract transfers control of the goods over time requires management to consider the terms of the contract, as well as any laws that apply to the contract, and make judgements as to (1) whether the asset created by the Company's performance does not have an alternative use to the Company if the Company is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use and (2) evaluating whether it has an enforceable right to payment for performance completed to date.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**

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

Revenue is measured based on the price specified in the sales contract.

Contract assets include unbilled amounts typically resulting from sales under purchase orders when over time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer, and right to payment is not just subject to passage of time. Amounts may not exceed their net realizable value.

Contract liabilities consist of advance payments and billings in excess of revenue recognized. Advance payments and billings in excess of revenue recognized are classified as current or non-current based on the timing of when revenue is expected to be recognized. Contract liabilities realization can extend, dependent on the amortization of the related costs, over one or more fiscal years. Certain program inventories have been funded by a customer, whereby the associated contract liability will be recorded as revenue upon delivery of units of production.

The Company's customer contracts with the U.S. government are subject to the Federal Acquisition Regulation ("FAR") and are competitively priced based on estimated costs of providing the contractual goods or services. The U.S. Government or the prime contractor may cancel any contract at any time through a termination for convenience or for cause. Many of our contracts have terms that create an enforceable right to payment for performance completed to date in the event of a termination for convenience. Variable consideration is estimated as the most likely amount to which we expect to be entitled and is recognized to the extent it is probable that a significant reversal will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

The Company has a customer contract with price adjustments where the selling price is increased for sales made over an initial specified period and a reduction in selling price for sales made in a subsequent specified period. This is a significant financing component for this contract considering the length of time between the customers' advance payment with the increased selling price and the delivery made in the subsequent periods, as well as the prevailing interest rate in the market. As such, the advance payment was recognized as contract liabilities and an interest on the advance payment is calculated using the Company's weighted average interest rate of debt. This rate is commensurate with the rate that would be reflected in a separate financing transaction between the Company and the customer at contract inception.

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 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 not recognized for 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.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**

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

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 income (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 is computed using the treasury stock method. The Company's potentially dilutive common shares comprise stock options granted to employees.

Lease**a) Right-of-use assets**

The Company recognizes right-of-use assets at the commencement date of the lease. Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognized, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Unless the Company is reasonably certain to obtain ownership of the leased asset at the end of the lease term, the recognized right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term. Right-of-use assets are subject to impairment.

b) Lease liabilities

At the commencement date of the lease, the Company recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Company and payments of penalties for terminating a lease, if the lease term reflects the Company exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognized as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Company uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. The incremental borrowing rate is the rate of interest that the Company would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the lease asset in a similar economic environment. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is re-measured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset.

c) Short-term leases and leases of low-value assets

The Company applies the short-term lease recognition exemption to its short-term leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option. It also applies the lease of low-value assets recognition exemption to leases of assets that are considered of low value. Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term.

d) Significant judgement in determining the lease term of contracts with renewal options

The Company determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised. The Company considers all relevant factors that create an economic incentive for it to exercise the renewal. After the commencement date, the Company reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew.

Government grants

The Company recognized government grant income related to the Canada Emergency Wage and Rent Subsidy and the U.S. Small Business Administration Paycheck Protection Program loan when there is reasonable assurance that the Company will comply with eligibility requirements and the grants will be received. The Company has recognized deferred government grant on wages capitalized as inventory. The deferred government grant will be recognized as income upon sale of the inventory.

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 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 are based on estimates and assumptions regarding the expected market outlook and cash flows from each of the Company's CGU. 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.

During the year the Company determined that the equipment, the right-of-use assets and intangible assets of its ACF cash generating unit were impaired. The equipment were written down to its recoverable amount of \$5,509,000 (USD \$4,345,000). The fair value less cost to sell of the equipment was determined by an independent appraiser using sales of comparable equipment or a cost approach. The main inputs were estimate of value based on recent sales of comparable equipment and estimates of the impact of physical deterioration, functional or technological obsolescence and external or economic obsolescence for value derived from using a cost approach. Management estimated that no value can be generated out of the right-of-use assets upon a sale or sublease, their fair value less cost of sell was estimated to be nil as at the end of the year.

- **Going concern and debt classification:** Management assesses the Company's ability to continue as a going concern at each reporting date, using 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.
- **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.

On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed \$10,112,000 of overhead costs during the current year (December 31, 2020: \$8,346,000) in respect of unutilized plant capacity. These amounts are included in the Consolidated Statements of 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. 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 total onerous contract provision for the year ended December 31, 2021 is \$1,864,000 (December 31, 2020: \$565,000).
- The values of right of use assets and lease liabilities require judgement in determining lease terms such as extension option and discount rate used. In the case where incremental borrowing rate is used, the Company estimates the incremental

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

borrowing rate based on the lease term, collateral assumptions, and the economic environment in which the lease is denominated.

- Upon termination for convenience for customer contracts subject to the Federal Acquisition Regulation ("FAR"), the Company must assess the contractual provisions that permit termination and the related contractual remedies available to recover all or a portion of our incurred costs and fees for work performed. Variable consideration is recognized as estimated revenue to the extent it is probable that a significant reversal in the amount of revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Management estimated the variable consideration using actual costs, an estimate of reasonable profit margin determined in accordance with the contractual provisions and historical experience, and delay cost estimated under the contractual entitlement subject to FAR. Although the Company believes its estimates and assumptions made are consistent with the terms and conditions of the contract, the actual settlement amount determined at a future date could materially affect the Company's reported financial results.
- The Company has determined that it will meet the eligibility requirements for forgiveness of the second wave U.S. Small Business Administration Paycheck Protection Program loan and has recognized \$2,513,000 (USD \$2,004,000) in other income in the current year.

5. Expenses by Nature

The Consolidated Statements of Loss presents expenses by function. Accordingly, amortization and depreciation are not presented as a separate line on the statement (with the exception of office equipment) but are included within cost of sales to the extent that it relates to manufacturing machinery and equipment, right of use assets or leasehold improvements.

Expenses by nature:

	2021	2020
Salary, wages, and benefits	\$50,938	\$59,117
Raw materials, purchased parts and consumables	41,649	65,028
Depreciation	7,147	8,338
Contract services & consulting	3,091	3,606
Utilities	2,906	3,491
Office equipment rental and maintenance	1,904	1,867
Other expenses and conversion costs into inventory	1,714	1,537
Transportation	1,677	1,926
Amortization of development costs	1,404	8,955
Rent	1,388	1,514
Legal and audit fees	1,387	1,509
Change in onerous contracts provision	1,299	308
Insurance	730	664
Amortization of intangible assets	91	1,197
Plant equipment rental and maintenance	581	900
Royalties	279	159
Office supplies	209	171
Travel costs	77	203
Bad debt expense (recovery)	75	(257)
	118,546	160,233

6. Capital Risk Management

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

The Company includes capital stock in its definition of capital, as shown in the Company's consolidated statements of financial position.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

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 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.

- **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 gain recorded for the year ended December 31, 2021 is \$295,000 (December 31, 2020: \$364,000 loss).

The Company had the following US dollar denominated balances:

AS AT DECEMBER 31

	2021	2020
Bank cash position	USD\$2,568	USD\$3,285
Accounts receivable	9,849	6,393
Accounts payable	5,843	3,726
Customer advance	-	4,643
Bank indebtedness	59,421	60,037
Term loan	11,143	10,322

With other variables unchanged, each \$0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately \$6,399,000 in net loss for the year ended December 31, 2021 as a result of holding a net liability position in USD as at December 31, 2021.

As at December 31, 2020, a \$0.10 strengthening (weakening) of the CAD against the USD would result in an increase (decrease) of approximately \$6,905,000 in net income for the year ended December 31, 2020 as a result of holding a net liability position in USD as at December 31, 2020.

- **Interest Rate Risk**

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit (note 16).

Interest rate for advances made up to the maximum of the allowable borrowing base of USD \$23,000,000 revolving loan less USD \$1,000,000:

- Royal Bank Prime ("RBP") plus 1.50% per annum
- Royal Bank US Base Rate ("RBUSBR") plus 1.50% per annum
- Banker's Acceptance ("BA") Equivalent Rate plus 3.00% per annum
- LIBOR Rate plus 3.00% per annum

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The utilized portion of this operating line of credit at year end amounting to \$18,303,000 (USD \$14,437,000).

Interest rate for advances made on the additional USD \$45,000,000 borrowing capacity up to USD \$68,000,000.

- 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

The utilized portion of this operating line of credit at year end amounting to \$57,032,000 (USD \$44,984,000).

The LIBOR has been subject to recent proposed reforms. The LIBOR will be phased out by June 30, 2023 which is consistent to the term of the loan agreement. The consequences of these developments cannot be predicted with certainty, however, no significant impact is expected.

The Company provided 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). On March 12, 2021, the Company has amended and restated the accommodation agreement with a customer and Panta B.V. Canada waiving all rights to the Guarantee Fee (note 24).

The maximum operating line of credit availability is \$84,943,000 (USD \$67,000,000) of which \$75,335,000 (USD \$59,421,000) is utilized as at December 31, 2021 (December 31, 2020: \$76,439,000 (USD \$60,037,000)). 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, 2021, with other variables unchanged, a 1% change in the base borrowing rate would have a \$753,000 (December 31, 2020: \$764,000) 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 \$7,879,000 (USD \$6,215,000) on its operating line of credit as at December 31, 2021 (December 31, 2020: \$1,762,000 (USD \$1,384,000)). As at the date of this report the Company is able to draw up to an additional \$3,092,000 (USD \$2,439,000) (note 16) on its operating line of credit.

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

b) Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group ("Boeing"), Boeing Defence, 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 88.0% (December 31, 2020: 89.6%) 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, 2021. 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 expected credit losses for trade receivables:

FOR THE YEAR ENDED DECEMBER 31	2021	2020
Balance as at January 1	\$29	\$355
Additions	4	36
Use	-	(42)
Collection	-	(320)
Balance as at December 31	33	29

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

The following table provides aged trade receivables:

AS AT DECEMBER 31	2021	2020
Current	\$16,270	\$9,531
31 – 60 days	936	1,379
61 – 90 days	187	1,400
Over 90 days	275	1,499
Total	17,668	13,809

c) Liquidity Risk

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

Current accounts payable and accrued liabilities are all due within the next twelve months. Term debt repayments are as outlined in note 20.

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

	December 31, 2021			
	Less than 3 months	3 months to 1 year	1 – 5 years	Over 5 years
Bank indebtedness (note 16)	\$-	\$-	\$74,412	\$-
Term debt (note 20)	1,042	1,999	21,930	4,226
Trade payables (note 18)	13,046	-	-	-
Payroll related liabilities (note 18)	4,610	-	-	-
Customer advance (note 17, 24)	-	-	-	-
Guarantee fee (note 16, 24)	-	-	-	-
Accrued interest (note 18)	131	-	-	-
Other accruals (note 18)	123	-	-	-

	December 31, 2020			
	Less than 3 months	3 months to 1 year	1 – 5 years	Over 5 years
Bank indebtedness (note 16)	\$76,708	\$-	\$-	\$-
Term debt (note 20)	1,205	15,663	13,413	5,755
Trade payables (note 18)	10,980	-	-	-
Payroll related liabilities (note 18)	5,242	-	-	-
Customer advance (note 17, 24)	5,911	-	-	-
Guarantee fee (note 16, 24)	-	8,178	-	-
Accrued interest (note 18)	159	-	-	-
Other accruals (note 18)	216	-	-	-

8. Fair Value Measurement

a) Categories of financial instruments

Under IFRS 9, financial instruments are classified into one of the following categories: financial assets at fair value through other comprehensive income and fair value through profit and loss, financial liabilities at fair value through profit or loss, and other financial liabilities and financial assets at amortized cost.

As at December 31, 2021 and December 31, 2020, the Company's financial assets and liabilities are categorized as follows:

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

AS AT DECEMBER 31

	2021		2020	
	Amortized cost	Total	Amortized cost	Total
Financial Assets				
Cash	\$4,060	\$4,060	\$7,044	\$7,044
Accounts receivable	18,116	18,116	14,436	14,436
Financial Liabilities				
Bank indebtedness	74,412	74,412	76,708	76,708
Trade payable	13,046	13,046	10,980	10,980
Term debt	29,197	29,197	36,036	36,036
Customer advance	-	-	5,911	5,911
Guarantee fee	-	-	8,178	8,178

b) Fair value measurement

As at December 31, 2021 and December 31, 2020, the fair values of cash, accounts receivable and accounts payable approximated their carrying values because of the current nature of these instruments. Bank indebtedness was classified as non-current as at December 31, 2021 upon the loan maturity extension to June 30, 2023.

AS AT DECEMBER 31

	2021		2020	
	Carrying value	Fair value	Carrying value	Fair value
Financial liabilities				
Bank indebtedness (level 2)	74,412	74,412	76,708	76,708
Term debt (level 2)	29,197	29,197	36,036	36,036
Customer advance (level 2)	-	-	5,911	5,911
Guarantee fee (level 2)	-	-	8,178	8,178

Fair value hierarchy

The Company's financial assets 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.

9. Accounts Receivable

AS AT DECEMBER 31

	2021	2020
Trade receivables	\$17,668	\$13,809
Input tax credits	396	545
Accrued receivables	52	82
	18,116	14,436

Trade receivables are non-interest bearing and are generally on terms of 30 to 90 days.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The accounts receivables are pledged as security under the Company's operating line of credit (note 16).

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

AS AT DECEMBER 31

	2021	2020
US dollar	USD\$10,079	USD\$6,813
Canadian dollar	5,337	5,761

10. Contract Assets

Contract assets include unbilled amounts typically resulting from sales under purchase orders and contracts, when certain conditions are met, namely: when over time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer, and right to payment is not solely subject to the passage of time. Amounts may not exceed their net realizable value. Contract Assets are released when the customer is invoiced and is recorded to accounts receivable. Contract assets also include variable consideration recognized upon contract modifications, determined using the most likely amount to which the Company is expected to be entitled.

A significant portion of the contract assets are pledged as security under the Company's operating line of credit (note 16).

AS AT DECEMBER 31

	2021	2020
Contract asset	\$31,398	\$34,325
Less: Current portion	13,319	34,325
Non-current portion	18,079	-

11. Inventories
AS AT DECEMBER 31

	2021	2020
Raw materials	\$10,427	\$8,296
Work-in-progress	5,122	5,160
Finished products	2,511	216
Inventory obsolescence	(5,251)	(4,015)
	12,809	9,657

The amount of inventory expensed in cost of sales during the year ended December 31, 2021, amounted to \$88,030,000 (December 31, 2020: \$125,428,000).

During the year ended December 31, 2021, \$802,000 (December 31, 2020, reversal of expense \$108,000) was recognized as an expense for inventories carried at net realizable value. This is recognized in cost of sales.

The inventories are pledged as security under the Company's operating line of credit (note 16).

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)
12. Prepayments and Other Assets
AS AT DECEMBER 31

	2021	2020
Deposits on material purchases	\$415	\$646
Prepaid and deposits on insurance	3,438	3,437
Prepaid IT security maintenance and licenses	570	459
Prepaid property tax	284	287
Prepaid and other deposits	252	156
	4,959	4,985
Less: Current portion	2,091	2,108
Non-current portion	2,868	2,877

13. Development Costs

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

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Opening balance	\$9,045	\$14,075
Additions	2,956	3,929
Amortization	(1,404)	(8,955)
Foreign exchange	-	(4)
	10,597	9,045

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Cost	\$33,938	\$30,982
Accumulated amortization	(23,341)	(21,937)
Net book amount	10,597	9,045

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)
14. Property, Plant and Equipment

	Building	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
Year ended December 31, 2020					
Opening net book amount	21,325	21,616	2,336	1,051	46,328
Additions	63	928	156	1,062	2,209
Disposals – cost	-	(1,701)	-	(95)	(1,796)
Disposals – accumulated depreciation	-	574	-	35	609
Depreciation charge	(3,515)	(3,962)	(638)	(223)	(8,338)
Transfers	-	(139)	47	92	-
Currency translation adjustment	(153)	(120)	(25)	(11)	(309)
Closing net book amount	17,720	17,196	1,876	1,911	38,703
At December 31, 2020					
Cost	24,511	57,994	10,860	4,029	97,394
Accumulated depreciation	(6,791)	(40,798)	(8,984)	(2,118)	(58,691)
Net book amount	17,720	17,196	1,876	1,911	38,703
Year ended December 31, 2021					
Opening net book amount	17,720	17,196	1,876	1,911	38,703
Additions	-	1,682	486	571	2,739
Disposals – cost	-	(3,101)	-	(51)	(3,152)
Disposals – accumulated depreciation	-	1,855	-	24	1,879
Depreciation charge	(3,006)	(3,228)	(587)	(326)	(7,147)
Impairment	(1,640)	(5,026)	(355)	(240)	(7,261)
Lease modification	(4,757)	(21)	-	-	(4,778)
Currency translation adjustment	(124)	(144)	(10)	(7)	(285)
Closing net book amount	8,193	9,213	1,410	1,882	20,698
At December 31, 2021					
Cost	24,459	56,441	11,339	4,545	96,784
Accumulated depreciation and impairment	(16,266)	(47,228)	(9,929)	(2,663)	(76,086)
Net book amount	8,193	9,213	1,410	1,882	20,698

Government grants of \$147,000 have been received for the purchase of certain items of property, plant and equipment. The amounts were deducted in the net book amount as shown above. There are no unfulfilled conditions or contingencies attached to these grants.

The Company has \$271,000 in commitments at December 31, 2021 (December 31, 2020: \$52,000) to purchase property, plant and equipment.

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

The Company leases various assets including buildings, equipment, and computer hardware and software. The following table summarizes the changes in right-of-use assets within Property, plant and equipment:

	Building	Machinery and equipment	Computer hardware and software	Total
January 1, 2020	21,325	781	1,014	23,120
Additions	63	265	112	440
Disposals - cost	-	(215)	-	(215)
Disposals - accumulated depreciation	-	59	-	59
Depreciation charge	(3,515)	(261)	(257)	(4,033)
Currency translation adjustment	(153)	57	(2)	(98)
At December 31, 2020	17,720	686	867	19,273
January 1, 2021	17,720	686	867	19,273
Lease modification	(4,757)	(21)	-	(4,778)
Additions	-	665	-	665
Depreciation charge	(3,006)	(206)	(244)	(3,456)
Impairment	(1,640)	(570)	(62)	(2,272)
Currency translation adjustment	(124)	(4)	(1)	(129)
At December 31, 2021	8,193	550	560	9,303

On February 25, 2021, the Company amended the ACF's facility lease agreement effective January 1, 2021 to vacate certain buildings by March 31, 2021, and reduced the lease term. This lease modification resulted in a reduction in value of the right-of-use asset of \$4,757,000 (USD \$3,794,000).

The impairment assessment of the ACF cash generating unit determined the right-of-use assets, plant and equipment and intangible assets are impaired due to historical operating losses and lower forecasted revenue. Boeing suspended deliveries of its 787 aircraft during 2021 which impacted Subaru's delivery requirement from ACF affecting current and forecasted revenue in ACF.

The plant and equipment were written down to its recoverable amount of \$5,509,000 (USD \$4,345,000). The fair value less cost to sell of the equipment was determined by an independent appraiser using sales of comparable equipment or a cost approach. The main inputs were estimate of value based on recent sales of comparable equipment and estimates of the impact of physical deterioration, functional or technological obsolescence and external or economic obsolescence for value derived from using a cost approach. Since these valuation inputs are unobservable inputs, the fair value of the plant and equipment is classified as a level 3 fair value.

As no value can be generated out of the right-of-use assets upon a sale or sublease, their fair value less cost of disposal was nil.

The \$7,261,000 impairment loss of these assets is included in the consolidated statement of loss.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)
15. Intangibles

	Lease	Customer contract – re-complete	Developed Software	Total
Year ended December 31, 2020				
Opening net book amount	\$-	\$1,065	\$762	\$1,827
Amortization charge	-	(1,100)	(97)	(1,197)
Currency translation adjustment	-	35	(10)	25
Closing net book amount	-	-	655	655
At December 31, 2020				
Cost	688	5,219	922	6,829
Accumulated amortization	(688)	(5,219)	(267)	(6,174)
Net book amount	-	-	655	655
Year ended December 31, 2021				
Opening net book amount	-	-	655	655
Amortization charge	-	-	(91)	(91)
Impairment	-	-	(554)	(554)
Currency translation adjustment	-	-	(10)	(10)
Closing net book amount	-	-	-	-
At December 31, 2021				
Cost	685	5,198	919	6,802
Accumulated amortization and impairment	(685)	(5,198)	(919)	(6,802)
Net book amount	-	-	-	-

The impairment loss relates to assets that were written down to their recoverable amounts (note 14). The amount was recognized as impairment loss in the consolidated statement of loss.

16. Bank Indebtedness

On May 26, 2017, the Company entered into a loan agreement for an expanded operating credit facility with a Canadian Chartered Bank. This loan agreement had a significant amendment on November 15, 2019. This loan agreement was further amended on June 22, 2021, to extend the maturity to June 30, 2023. The Company recorded a net gain on modification of bank indebtedness of \$1,155,000 (USD \$932,000) as a result of executing this amending agreement.

- Maximum availability under the loan agreement cannot exceed USD \$68,000,000 less USD \$1,000,000 until June 30, 2023. USD \$45,000,000 borrowing capacity under the loan agreement is supported by a customer of the Company (the "Guarantor") by way of a guarantee (the "Guarantee"). On November 15, 2019, Panta Holdings B.V., the holding company of Panta Canada B.V. which is Avcorp's majority shareholder, entered into a guarantee agreement with the Guarantor. Pursuant to the guarantee agreement, Panta Holdings B.V. provided a guarantee to the Guarantor in the maximum payment of USD \$10,000,000 if the bank draws on the Guarantee in whole or in part.
- Interest rate for advances made up to the maximum of the allowable borrowing base of USD \$23,000,000 revolving loan less USD \$1,000,000:
 - Royal Bank Prime ("RBP") plus 1.50% per annum
 - Royal Bank US Base Rate ("RBUSBR") plus 1.50% per annum
 - Banker's Acceptance ("BA") Equivalent Rate plus 3.00% per annum
 - LIBOR Rate plus 3.00% per annum
- Interest rate for advances made on the additional USD \$45,000,000 borrowing capacity up to USD \$68,000,000.
 - RBP plus 0.00% per annum
 - RBUSBR plus 0.00% per annum

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

- BA Equivalent Rate plus 0.875% per annum
- LIBOR Rate plus 0.875% per annum

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.

The Company provided 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). On March 12, 2021, the Company has amended and restated the accommodation agreement with the Guarantor and Panta B.V. Canada waiving all rights to the Guarantee Fee (note 24).

The Company ended the year with bank operating line utilization of \$75,335,000 (USD \$59,421,000) offset by \$4,060,000 cash compared to utilization of \$76,439,000 (USD \$60,037,000) with \$7,044,000 cash on hand as at December 31, 2020. The bank indebtedness balance of the modification gain and related adjustments as a result of executing the amending agreement in 2021 was \$923,000 as at December 31, 2021, (December 31, 2020: loss \$269,000 from 2019 amendment). Based on net collateral provided to its bank, the Company is able to draw up to an additional \$7,879,000 (USD \$6,215,000) on its operating line of credit as at December 31, 2021 (December 31, 2020: \$1,762,000 (USD\$1,384,000)). As at the date of this report the Company is able to draw up to an additional \$3,092,000 (USD\$2,439,000) on its operating line of credit.

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Opening balance	\$76,708	\$85,470
Drawdowns on bank indebtedness	1,266	653
Amortization of loan modification loss	(269)	(540)
Loan modification gain	(1,155)	-
Amortization of loan modification gain	306	-
Repayment of loans	(2,105)	(7,368)
Foreign exchange gain	(339)	(1,507)
Ending balance	74,412	76,708

The carrying amount of accounts receivable pledged as security under the Company's operating line of credit as at December 31, 2021 is \$13,245,000 (December 31, 2020: \$8,605,000). The inventory and contract asset pledged as security under the Company's operating line of credit as at December 31, 2021, is \$21,452,000 (December 31, 2020: \$20,306,000).

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; such event occurred during the third quarter 2018. 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.

On March 12, 2021, the Company has amended and restated the accommodation agreement with a customer and Panta B.V. Canada settling and waiving all rights to the customer advance (note 24).

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

FOR THE YEAR ENDED DECEMBER 31

Opening balance
Released upon accommodation agreement
Foreign exchange

2021	2020
\$5,911	\$6,030
(5,800)	-
(111)	(119)
-	5,911

18. Accounts Payable and Accrued Liabilities

AS AT DECEMBER 31

Trade payables
Claims provision (note 24)
Payroll-related liabilities
Restoration provision
Accrued interest
Other

2021	2020
\$13,046	\$10,980
3,406	10,859
4,610	5,242
487	476
131	159
123	216
21,803	27,932
19,792	27,932
2,011	-

Less: Current portion

Non-current portion

19. Contract Liability

FOR THE YEAR ENDED DECEMBER 31

Opening balance
Additions
Realized

2021	2020
\$14,691	\$6,793
49,838	46,550
(41,061)	(38,652)
23,468	14,691
18,625	11,502
4,843	3,189

Less: Current portion

Non-current portion

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.

The Company has a customer contract with price adjustments where the selling price is increased for sales made over an initial specified period and a reduction in selling price for sales made in a subsequent specified period. This is a significant financing component for this contract considering the length of time between the customers' advance payment with the increased selling price and the delivery made in the subsequent periods, as well as the prevailing interest rate in the market. As such, the advance payment was recognized as contract liabilities and an interest on the advance payment is calculated using the Company's weighted average interest rate of debt. This rate is commensurate with the rate that would be reflected in a separate financing transaction between the Company and the customer at contract inception.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)
20. Term Debt
AS AT DECEMBER 31

	2021	2020
Lease liabilities (a)	\$11,750	\$18,243
Panta loans (b)	14,127	13,142
SADI loans (c)	3,320	3,734
PPP loans (d)	-	917
	29,197	36,036
Less: Current portion	3,041	16,868
Non-current portion	26,156	19,168

a) Lease Liabilities

There are various lease liabilities that have a weighted average interest rate of 9.0% per annum (December 2020: 9.0%). The leases are secured by way of a charge against specific assets. The leases are repayable in installments over periods up to 10 years.

On February 25, 2021, the Company amended the Avcorp Composite Fabrication Inc.'s Gardena facility lease agreement effective January 1, 2021, to vacate certain buildings and renegotiated new lease terms. The lease liability related to the lease agreement was revalued from \$6,666,000 (USD \$5,317,000) to \$2,115,000 (USD \$1,687,000) due to reduced monthly lease payments over reduced lease term.

The table below categorizes the lease liability into relevant maturity periods based on the remaining periods from the consolidated statement of financial position date to the maturity date.

	December 31, 2021		
	Within 1 Year	Between 1 – 5 Years	Over 5 Years
Lease liability	\$2,712	\$6,487	\$2,551

	December 31, 2020		
	Within 1 Year	Between 1 – 5 Years	Over 5 Years
Lease liability	\$2,619	\$11,639	\$3,985

b) Panta Loan

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 70.6% of the issued and outstanding common shares. 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 Avcorp, is the sole shareholder of Panta Holdings B.V.

On August 24, 2018, Avcorp entered into a non-revolving term loan agreement ("2018 Panta loan") with Panta Canada B.V. ("Panta") in the principal amount of USD\$3,500,000.

On November 15, 2019, the Company entered into a standby credit facility agreement ("2019 Panta Loan") with Panta Canada B.V. which amended and restated the 2018 Panta Loan, as well as securing an additional \$4,566,000 (USD\$3,500,000). The Company had drawn the full amount on this 2019 Panta Loan in December 2019 and January 2020.

On March 2, 2020, the Company entered into an amendment to the 2019 Panta Loan securing and drawing an additional \$2,686,000 (USD\$2,000,000). As at December 31, 2021, the Company is able to draw up to an additional \$Nil on the standby credit facility.

- The loan is subordinated to existing security agreements, except that in the event that Avcorp sells its wholly-owned subsidiary, Comtek Advanced Structures Ltd., Avcorp shall pay to Panta an amount up to the indebtedness then outstanding under the loan, subject to any priority payment required by the bank indebtedness and provided there does not then exist an event of default under the loan agreement (note 16).

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

- 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. If either an event of default occurs and is continuing or the indebtedness is not repaid in full on the maturity date, the interest rate in such period shall increase to the rate of 15% per annum and all outstanding indebtedness, including unpaid interest, shall continue to accrue interest at such increased rate of interest from and after the maturity date until paid in full.
- The maturity date is the earlier of: (i) the date upon which, for any reason, the outstanding principal balance of the operating credit facility established under the loan agreement becomes due and owing; (ii) June 30, 2023; and (iii) the date on which there is an acceleration of the loan as a result of a written demand by Panta following the occurrence and during the continuance of an uncured event of default. No such events have occurred and therefore, the Panta Loan is long term in nature.
- Upon the happening of any event of default, Panta may at its option: (i) declare that the indebtedness has become immediately due and payable; and (ii) declare that the indebtedness has become immediately due and payable and elect to convert all or part of the indebtedness into common shares of Avcorp at an exercise price equivalent to the then market price at the time of conversion which shall not exceed \$0.15 per common share.

On March 12, 2021, the Company has amended and restated the accommodation agreement with a customer and Panta B.V. Canada providing an additional USD \$10,000,000 by way of a non-revolving standby loan facility and USD \$3,000,000 equipment loan ("2021 Panta Loan") (note 24). As at December 31, 2021, the Company is able to draw USD \$13,000,000 on the 2021 Panta Loan.

- The 2021 Panta Loan carries the same terms and conditions as noted above for the 2018 Panta Loan and 2019 Panta Loan except for interest. The 2021 Panta 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 plus a margin of 2% per annum which shall accrue and not be compounded until the maturity date. If either an event of default occurs and is continuing or the indebtedness is not repaid in full on the maturity date, the interest rate in such period shall increase to the rate of 10% per annum and all outstanding indebtedness, including unpaid interest, shall continue to accrue interest at such increased rate of interest from and after the maturity date until paid in full.

FOR THE YEAR ENDED DECEMBER 31

Opening balance
Add: Draw down
Add: Accrued interest
Foreign exchange gain

2021	2020
\$13,142	\$5,550
-	6,924
1,030	1,079
(45)	(411)
14,127	13,142

c) SADI Loans

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;
- Annual repayments are to occur over a 15-year term, commencing four months following the 2018 fiscal year end with subsequent annual repayments to be paid within four months following the Company's then fiscal year ends. In September 2020 the Company received a 9 months deferral of repayment obligations from the Government of Canada for the scheduled payment in 2020 and all the subsequent annual payments in response to COVID-19;
- Amounts repayable are unsecured.

\$3,320,000 was drawn on this facility as at December 31, 2021 (December 31, 2020: \$3,734,000).

	December 31, 2021	December 31, 2020
Opening balance	\$3,734	\$3,573
Add: Accrued interest	142	161

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

Less: Repayments	(556)	-
Ending Balance	3,320	3,734
Less: Current portion	329	556
Non-current portion	2,991	3,178

d) Paycheck Protection Program Loan

On April 28, 2020, the Company received a loan in the amount of \$5,529,000 (USD \$4,123,000) from a U.S. Chartered Bank through the U.S. Small Business Administration Paycheck Protection Program ("PPP Loan"). The loan has a term of 2 years. The loan bears interest at a fixed rate of 1% per annum. The Company has determined that \$4,601,000 (USD \$3,430,000) met the forgiveness criteria and the amount was included in the year ended December 31, 2020, as other income (note 27).

On June 8, 2021, the Company received approval for forgiveness on the full loan amount of USD \$4,123,000. The Company recognized the remaining portion of loan forgiveness and related interest of \$924,000 (USD \$737,000) as other income in the year ended December 31, 2021 (note 27).

On March 15, 2021, the Company received a \$2,508,000 (USD \$2,000,000) second wave PPP loan and has determined that the full loan amount and the related interest of \$2,513,000 (USD \$2,004,000) met the forgiveness criteria and the amount is included in the year ended December 31, 2021, as other income (note 27).

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Opening balance	\$917	\$-
Add: Accrued interest	27	37
Add: Contributions	2,508	5,529
Less: Loan forgiveness	(3,437)	(4,601)
Less: Foreign exchange gain	(15)	(48)
Ending Balance	-	917

21. Onerous Contract Provision

The Company entered into production contracts in the ordinary course of business. The unavoidable costs of meeting the obligations under certain of these contracts exceed the associated expected future net benefits; consequently, an onerous contract provision has been recognized. The calculation of this provision involves the use of estimates. The onerous contract provision is calculated by taking the expected future costs that will be incurred under the contracts and deducting any estimated revenues. The onerous contract provision for the year ended December 31, 2021, is \$1,864,000 (December 31, 2020: \$565,000).

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Opening balance	\$565	\$251
Additions	1,864	565
Amortization	(565)	(257)
Foreign exchange loss	-	6
Balance	1,864	565
Less: Current portion	1,324	282
Non-current portion	540	283

22. Obligations, Commitments and Contingent Liabilities

The Company has \$270,000 in commitments at December 31, 2021 (December 31, 2020: \$52,000) to purchase property, plant and equipment in 2021.

As at December 31, 2021, including the above, the Company had a total of \$29,893,000 of committed contractual operational purchase order obligations outstanding (December 31, 2020: \$35,238,000).

Notes to Consolidated Financial Statements
For the year ended December 31, 2021
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)
23. 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 370,931,120 common shares issued at December 31, 2021.

Common shares issued or reserved:

	Number of shares	Amount
December 31, 2019	368,118,620	86,219
Share issue		
Exercise of stock warrants	-	-
Transfer from contributed surplus on exercise of stock warrants	-	-
December 31, 2020	368,118,620	86,219
Share issue		
Cash	2,812,500	112
Transfer from contributed surplus on exercise of stock options	-	125
December 31, 2021	370,931,120	86,456

During the fourth quarter of 2021, holder of the Company's stock options exercised 2,812,500 stock options at a price of \$0.04 resulting in the issuance of 2,812,500 common shares with a value of \$112,000. Weighted average share price at the date of exercise is \$0.07.

The Company's incentive stock option plan is administered by the Board of Directors. It is a rolling share option plan wherein 15% 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, 2021 and December 31, 2020, and changes during the periods ending on those dates, are presented below:

FOR THE YEAR ENDED DECEMBER 31

	2021		2020	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding – Beginning of year	5,441,000	\$0.048	11,443,000	\$0.067
Granted	17,350,000	0.088	-	-
Forfeited	-	-	-	-
Expired	(730,500)	0.085	(6,002,000)	0.085
Exercised	(2,812,500)	0.040	-	-
Outstanding – End of year	19,248,000	0.083	5,441,000	0.048

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The following table summarizes stock options as at December 31, 2021:

	Number	Weighted average remaining contractual life (years)	Weighted average exercise price
Stock options outstanding as at December 31, 2021	19,248,000	4.11	0.083
Stock options exercisable as at December 31, 2021	18,310,500	4.06	0.086

24. Accommodation Agreement Settlement

On March 12, 2021, the Company entered into a multiparty amended and restated Accommodation Agreement with each of a customer, and Panta Canada B.V. whereby, inter-alia;

- Panta Canada B.V. has agreed to provide a USD \$10,000,000 non-revolving standby loan facility and a USD \$3,000,000 equipment loan for an aggregate availability of USD \$13,000,000; and
- The elimination of unamortized cash advance, mutual release and forgiveness of certain historic and future guarantee fees payable to the customer, and a legal claim provision. \$21,391,000 was released to the Consolidated Statements of Loss for the year ended December 31, 2021.
- The Company is required to use a portion of the variable consideration at the time of settlement of the termination of convenience towards permanently reducing the maximum availability of the guaranteed portion of the bank indebtedness.

25. Stock Based Compensation

Under the Avcorp 2007 Share Option Plan (the "Plan"), the Company is authorized to issue up to 15% of the Company's outstanding common shares.

All options have a contractual life of up to a maximum of ten years. Vesting of options is at the discretion of the plan administrator and is generally subject to the employees remaining employed by or continuing to provide services to the Company or remaining as a Director or Officer during the vesting period. As of December 31, 2021, the Company had issued 19,248,000 options under the Plan.

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

The fair value of 17,350,000 stock options granted and vested immediately during the year ended December 31, 2021, was \$1,376,000 (December 31, 2020: Nil), at a weighted average fair value of \$0.079. The contractual term of these share options is five years.

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

	2021
Number of options	17,350,000
Risk free rate (%)	0.99
Dividend yield (%)	-
Expected Lives (years)	5
Volatility (%)	137.68
Exercise price	0.0875

The amount of stock-based compensation expense, for options granted in current and prior periods, amortized to earnings during the year ended December 31, 2021, was \$1,389,000 (December 31, 2020: \$32,000). Stock-based compensation expense has been included in the Consolidated Statements of Loss as administrative and general expenses.

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021**
(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)

The expected life of the share options is based on historical data and current expectations and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options is indicative of future trends, which may not necessarily be the actual outcome.

26. Defined Contribution Plan

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

FOR THE YEAR ENDED DECEMBER 31

Defined contribution plan

2021	2020
\$1,318	\$1,409

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. \$413,000 of the defined contribution plan expenses have been included in the Consolidated Statements of Loss as administrative and general expenses (December 31, 2020: \$479,000) and \$905,000 have been included in cost of sales (December 31, 2020: \$930,000).

27. Other Income and Losses

The Canada Emergency Wage and Rent Subsidies ("CEWS" and "CERS") from the Canadian Government for the year ended December 31, 2021, of \$4,389,000 (December 31, 2020: \$6,796,000) and \$394,000 (December 31, 2020: \$Nil) respectively were included in the Consolidated Statements of Loss as other income. There are no unfulfilled conditions or other contingencies attaching to these grants.

On April 28, 2020, the Company received a loan in the amount of \$5,529,000 (USD \$4,123,000) from a U.S. Chartered Bank through the U.S. Small Business Administration Paycheck Protection Program ("PPP Loan"). The loan has a term of 2 years. The loan bears interest at a fixed rate of 1% per annum. The Company has determined that \$4,601,000 (USD \$3,430,000) met the forgiveness criteria and the amount was included in the year ended December 31, 2020, as other income. On June 8, 2021, the Company received approval for forgiveness on the full loan amount of USD \$4,123,000. The Company recognized the remaining portion of loan forgiveness and related interest of \$924,000 (USD \$737,000) as other income in the year ended December 31, 2021.

On March 15, 2021, the Company received a \$2,508,000 (USD \$2,000,000) second wave PPP loan and has determined that the full loan amount and the related interests of \$2,513,000 (USD \$2,004,000) met the forgiveness criteria. The full loan amount and related interest is included in the year ended December 31, 2021 as other income.

On February 25, 2021, the Company amended the Avcorp Composite Fabrication Inc.'s Gardena facility lease agreement effective January 1, 2021, to vacate certain buildings by March 31, 2021, and reduced the lease term. As the lease modification is not accounted for as a separate lease, the Company remeasured the lease liability by discounting the revised lease payments on revised lease term and revalued the right of use asset with a loss on modification of the lease recognized in the Consolidated Statements of Loss in the year ended December 31, 2021 as other loss.

FOR THE YEAR ENDED DECEMBER 31

 Canada Emergency Wage Subsidy
 Canada Emergency Rent Subsidy
 Government loan forgiven
 Lease modification loss
 Others

2021	2020
\$4,389	\$6,796
394	-
3,437	4,601
(204)	-
164	245
8,180	11,642

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

28. Finance Costs

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Interest on lease liabilities	\$1,207	\$1,797
Interest on other term debt	169	198
Interest on bank indebtedness	1,688	4,524
Modification gain on bank indebtedness (note 16)	(1,155)	-
Interest on related party debt	1,030	1,079
Non-cash financing cost accretion	11	10
Interest on contract liabilities	146	119
Interest expense	3,096	7,727
Interest income	(5)	(122)
Net interest expense	3,091	7,605

29. Supplementary Cash Flow Information

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Equipment acquired under lease liability	\$665	\$440

30. 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 27%.

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.

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 \$34,073,000 (2020: \$33,488,000) in respect of losses amounting to \$85,381,000 (2020: \$75,676,000) which include foreign losses of \$50,106,000 (2020: \$40,329,000) that will expire beginning in 2035 through 2041 (except U.S. Net Operating Losses incurred from fiscal 2018 onwards of \$24,166,000 that carryforward indefinitely), unclaimed research and development costs of \$10,037,000 (2020: \$9,940,000) and capital losses of \$1,512,000 (2020: \$830,000) with no expiry, investment tax credits of \$969,000 (2020: \$1,109,000) which expire beginning in 2022 through 2037, and deductible temporary differences of \$26,937,000 (2020: \$35,255,000).

Income tax expense reported differs from the amount computed by applying the combined Canadian federal and provincial income tax rates, applicable to Avcorp Industries Inc., to the loss before taxes due to the following:

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Canadian federal and provincial income tax rates	27.00%	27.00%
Income tax recovery at statutory rate	\$(145)	\$(1,816)
Change in unrecognized temporary differences	851	2,972
Tax rate differences	(96)	(42)
Permanent differences on loan forgiveness	(962)	(1,286)
Other permanent differences	352	172
Tax expense (recovery)	-	-

31. Related Party Transactions

- a) Periodically, consulting services are provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the year ended December 31, 2021, amount to \$Nil (December 31, 2020: \$Nil). Fees payable to certain directors or Companies with which they have beneficial ownership, as at December 31, 2021, are \$Nil

**Notes to Consolidated Financial Statements
For the year ended December 31, 2021***(all figures in tables are expressed in thousands of Canadian dollars, except per share amounts)*

(December 31, 2020: \$Nil). These fees are included in the Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amount to \$Nil for the year ended December 31, 2021, (December 31, 2020: \$Nil).

b) Key management compensation

Key management includes members of the Board of Directors of the Company and executive officers for all operating facilities, as they have the collective authority and responsibility of planning, directing, and controlling the activities of the Company. The compensation expense for key management for services is shown below.

FOR THE YEAR ENDED DECEMBER 31

	2021	2020
Salaries and other short-term employee benefits	\$2,672	\$1,867
Contributions to defined contribution plan	97	91
Option-based awards	1,357	32
	4,126	1,990

c) Loans to related parties

The balance of loans receivable from key management as at December 31, 2021, is \$5,000 (December 31, 2020: \$5,000). These loans are unsecured and payable on demand.

Other related party transactions are disclosed elsewhere in these consolidated financial statements (note 20).

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

32. Earnings per share

Weighted average number of common shares for basic earnings per share as at December 31, 2021 is 368,257,319 (December 31, 2020: 368,118,620). Effect of dilution was not applicable in both years.

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.

33. 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 reportable segments 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.

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

- a) Sales to five major customers for the year ended December 31, 2021, which comprise several programs and contracts, accounted for approximately 88.3% (December 31, 2020: 92.3%) of sales.

FOR THE YEAR ENDED DECEMBER 31

	2021		2020	
	Revenue	% of Total	Revenue	% of Total
BAE Systems	\$40,508	40.7	\$31,332	20.8
Boeing ¹	26,047	26.2	48,237	31.9
Bombardier	10,796	10.9	12,998	8.6
Lockheed Martin	6,208	6.2	30,444	20.2
Subaru Corporation	4,299	4.3	16,311	10.8
Other	11,618	11.7	11,640	7.7
Total	99,476	100.0	150,962	100.0

1. Includes Boeing program partner revenue consisting of industry tier-one suppliers to Boeing

- b) The Company's sales are distributed amongst the following geographical locations based on location of customers:

FOR THE YEAR ENDED DECEMBER 31

	2021		2020	
	Revenue	% of Total	Revenue	% of Total
Europe	41,152	41.4	32,134	21.3
USA	35,555	35.7	81,317	53.9
Canada	17,388	17.5	19,801	13.1
Asia	4,706	4.7	17,462	11.6
Australia	674	0.7	186	0.1
Other	1	-	62	0.0
Total	99,476	100.0	150,962	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.

AS AT DECEMBER 31

	2021	2020
Canada	\$83,486	\$84,644
USA	19,151	36,894
Total	102,637	121,538

- d) The Company's sales are distributed amongst commercial and defence markets:

FOR THE YEAR ENDED DECEMBER 31

	2021		2020	
	Revenue	% of Total	Revenue	% of Total
Commercial	\$46,484	46.7	\$63,179	41.9
Defence	52,992	53.3	87,783	58.1
Total	99,476	100.0	150,962	100.0

- e) The Company's revenue is recognized either at a point in time or over time. For the year ended December 31, 2021, revenue earned at a point in time is \$13,854,000 (December 31, 2020: \$26,700,000). Revenue earned over time is \$85,622,000 for the year ended December 31, 2021 (December 31, 2020: \$124,262,000).

Avcorp Industries Inc.

annual report 2021

Notes to Consolidated Financial Statements For the year ended December 31, 2021

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

- f) 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, 2021

	Total	ASI	Comtek	ACF	Corporate
Revenue	\$99,476	\$75,976	\$13,373	\$10,127	\$-
Cost of sales	99,546	67,267	10,714	21,565	-
Gross profit (loss)	(70)	8,709	2,659	(11,438)	-
Administrative and general expenses	18,277	5,853	2,550	4,176	5,698
Depreciation and amortization	723	310	60	353	-
Accommodation agreement settlement	(21,391)	-	-	-	(21,391)
Impairment loss	7,815	-	-	7,815	-
Other income	(8,180)	(4,122)	(670)	(3,388)	-
Operating income (loss)	2,686	6,668	719	(20,394)	15,693

FOR THE YEAR ENDED DECEMBER 31, 2020

	Total	ASI	Comtek	ACF	Corporate
Revenue	\$150,962	86,756	\$16,509	\$47,697	\$-
Cost of sales	142,729	75,868	13,941	52,920	-
Gross profit (loss)	8,233	10,888	2,568	(5,223)	-
Administrative and general expenses	16,717	5,779	2,288	4,247	4,403
Depreciation and amortization	787	314	60	413	-
Other income	(11,642)	(5,523)	(1,273)	(4,846)	-
Operating income (loss)	2,371	10,318	1,493	(5,037)	(4,403)

AS AT DECEMBER 31

	2021		2020	
	Total Assets	% of Total	Total Assets	% of Total
Avcorp Industries Inc.	\$72,258	70.4	\$72,163	59.3
Comtek Advanced Structures Ltd.	11,078	10.8	12,345	10.2
Avcorp Composite Fabrication Inc.	19,151	18.7	36,894	30.4
Corporate	150	0.1	136	0.1
Total	102,637	100.0	121,538	100.0

AS AT DECEMBER 31

	2021		2020	
	Development Cost Additions	Property, Plant and Equipment Additions	Development Cost Additions	Property, Plant and Equipment Additions
Avcorp Industries Inc.	\$2,814	\$1,741	\$3,599	\$1,651
Comtek Advanced Structures Ltd.	51	327	175	118
Avcorp Composite Fabrication Inc.	91	671	155	440
Total	2,956	2,739	3,929	2,209

Avcorp Industries Inc.

annual report **2021**

Notes to Consolidated Financial Statements

For the year ended December 31, 2021

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

AS AT DECEMBER 31

	2021		2020	
	Total Liabilities	% of Total	Total Liabilities	% of Total
Avcorp Industries Inc.	\$52,366	34.7	\$41,361	24.2
Comtek Advanced Structures Ltd.	2,383	1.6	3,037	1.8
Avcorp Composite Fabrication Inc.	5,984	4.0	19,630	11.5
Corporate	90,011	59.7	106,650	62.5
Total	150,744	100	170,678	100.0

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

Tucson, Arizona

Jaap Rosen Jacobson ^(2*)

DIRECTOR

President

Panta Holdings B.V.

Mijdrecht, The Netherlands

Ken Robertson ^(1*)

DIRECTOR

Vancouver, British Columbia

Amandeep Kaler

DIRECTOR

Surrey, British Columbia

(1) Member of the Audit and Corporate Governance Committee

(2) Member of the Compensation and Nominating Committee

*Designates the Committee Chair

MANAGEMENT

Amandeep Kaler

Group Chief Executive Officer

Surrey, British Columbia

Jessica Gill

Group Vice President, Human Resources & IT

Surrey, British Columbia

Amish Patel

Group Vice President, Finance

North Vancouver, British Columbia

Robin Lovell

President

Comtek Advanced Structures Ltd.

Oakville, Ontario

Tony Kelsey

General Manager

Avcorp Composite Fabrication Inc.

Jurupa Valley, California

Mike Elvidge

General Manager

Avcorp Structures and Integration

Surrey, British Columbia

DIRECTORY

Legal Counsel

McMillan LLP

Barristers & Solicitors

Vancouver, British Columbia

Registrar and Transfer Agent

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Vancouver, British Columbia

Avcorp Industries Inc.

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Chartered Professional Accountants

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Bank

Royal Bank of Canada

Richmond, British Columbia

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Shares Listed

Toronto Stock Exchange

Symbol AVP

