First Quarter Report
2017

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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 (formerly Fuji Heavy Industries). The Avcorp Group has more than 50 years of experience, over 750 skilled employees and 636,000 square feet of facilities. Avcorp Structures & Integration located in Delta British Columbia, Canada is dedicated to metallic and composite aerostructures assembly and integration; Avcorp Engineered Composites located in Burlington Ontario, Canada is dedicated to design and manufacture of composite aerostructures, and Avcorp Composite Fabrication located in Gardena California, USA has advanced composite aerostructures fabrication capabilities for composite aerostructures. The Avcorp Group offers integrated composite and metallic aircraft structures to aircraft manufacturers, a distinct advantage in the pursuit of contracts for new aircraft designs, which require lower-cost, light-weight, strong, reliable structures. Comtek Advanced Structures Ltd., at our Burlington, Ontario, Canada location also provides aircraft operators with aircraft structural component repair services for commercial aircraft.

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

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

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

management discussion & analysis

This Management Discussion and Analysis has been prepared as of June 29, 2017, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2016.

Description of Business

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

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

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

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

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

Avcorp is in compliance with industry standard quality certifications.

2017 Highlights

Key financial results include:

- The Lessor of the Industrial Centre at Gardena California, where ACF has its manufacturing facilities, received an offer from a third party to purchase the Industrial Centre. On March 28, 2017 Avcorp exercised its right of first refusal under the lease agreement by providing notice to the Lessor that it proposes to purchase the property on the same terms and conditions as presented in the Offer. Avcorp has up to 270 days from the date of providing such notice to present and close a sale transaction with the Lessor. In addition, Avcorp entered into a Memorandum of Understanding and a Letter Agreement with Stockdale Acquisitions LLC to negotiate a joint venture agreement for the ultimate acquisition and development of the property in exchange for a long term lease by Avcorp of a portion of the property on favourable economic terms. On June 26, 2017, Avcorp provided notice to the Lessor of the Industrial Centre at Gardena California that it has elected not to proceed with the acquisition of the property.
- On April 4, 2017, the Company collected the final amount of consideration receivable from SGL Carbon SE ("SGL") for the acquisition of the US-based composite Aerostructures division of Hitco, a subsidiary of Frankfurt-listed SGL ("Hitco"), amounting to USD$9.2 million.
- On May 26, 2017, the Company signed a loan agreement to replace the current agreement with a Canadian Chartered Bank, supported by a major customer, to access a USD$58 million operating line of credit.

Financial Overview

Quarterly Results

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

QUARTERLY RESULTS

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

	2017	2016[2]				2015		
FOR THE THREE MONTHS ENDED	**Mar 31**	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31[3]	Sep 30	Jun 30
Revenue	**$38,568**	$46,183	$47,349	$50,234	$39,941	$22,776	$21,610	$20,369
Operating (loss) income	**(8,617)**	9,233	(12,060)	(6,010)	(7,568)	(5,796)	(2,030)	(1,125)
EBITDA[1]	**(6,927)**	10,679	(9,736)	(4,854)	(5,857)	(4,566)	(556)	(623)
Net (loss) income	**(9,447)**	8,762	(11,286)	(6,180)	(7,260)	(6,205)	(2,053)	(1,135)
EBITDA per share[1]								
Basic	**(0.02)**	(0.04)	(0.03)	(0.02)	(0.02)	(0.02)	(0.00)	(0.00)
Diluted	**(0.02)**	(0.04)	(0.03)	(0.02)	(0.02)	(0.02)	(0.00)	(0.00)
Net (loss) income per share								
Basic	**(0.03)**	(0.03)	(0.04)	(0.03)	(0.02)	(0.02)	(0.01)	(0.00)
Diluted	**(0.03)**	(0.03)	(0.04)	(0.03)	(0.02)	(0.02)	(0.01)	(0.00)
Long-term debt	**1,617**	1,646	1,674	1,650	1,649	1,646	1,634	1,542

1. EBITDA = earnings before interest, taxes, depreciation and amortization. This is not a recognized term under International Financial Reporting Standards ("IFRS"), refer to page 11.
2. It should be noted that in 2016, the loss and EBITDA incorporated substantial costs incurred which have yet to be recovered from the seller of Hitco. No recovery of these costs has been recorded, as an estimated amount cannot be reasonably determined at this time.

Three Months Ended March 31, 2017 and 2016 Results Overview

During the quarter ended March 31, 2017 Avcorp Group revenues totalled $38,568,000 compared with $39,941,000 for the same quarter in the previous year.

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

2017 revenues arising from the assignment by customers of commercial aerospace contracts to Avcorp Industries Inc. in conjunction with the December 18, 2015 Hitco acquisition have generated $13,255,000 in revenue (March 31, 2016: $15,071,000). These contracts support customer production of commercial aircraft. Manufacturing of the composite parts occurs in Avcorp Group's **Gardena facility**. The Gardena facility was assigned defence aerospace contracts by Hitco's customers upon the finalization of the acquisition. These contracts generated $4,710,000 of revenue during the quarter ended March 31, 2017 for ACF (March 31, 2016: $2,497,000). Issues with deliveries of products and services within the Gardena production supply chain were the primary cause for this facility not to have delivered to available customer demand. The March 31, 2017 increase of the Company's existing credit facility with a Canadian chartered bank to USD$23,000,000 alleviated supply chain constraints and has since provided the necessary liquidity to commence normal operating conditions.

The **Burlington facility** had a decline in the delivery of composite floor panels in supply to Bombardier Aerospace's Global 5000/6000 and Global 7000/8000 programs during the current quarter, with a decrease of 9% in production for these contracts in Q1 2017 versus Q1 2016 as the customer adjusted its inventory levels. Full rate production for these programs establishes the wholly owned subsidiary as a leading manufacturer of composite floor panels. Composite floor panel revenues arising from aftermarket or spare component sales increased slightly during Q1 2017 relative to Q1 2016 offsetting the Global 5000/6000 and Global 7000/8000 reduction in deliveries. While composite floor panel revenues derived from sales to original equipment manufacturers ("OEM") of regional aircraft decreased 27% during the same three month period; primarily as a result of a shift in customer demand. Composite aircraft repair revenues out of Comtek were $783,000 lower in the first quarter 2017 in comparison to the same quarter in 2016, as regional airline customers implement cost reduction initiatives and fleet aircraft mix changes. In summary, Avcorp's Burlington operations decreased revenue in 2017 relative to 2016 by $1,169,000.

Delta facility revenues, for all programs generated by legacy production contracts, have increased by $2,832,000 during the current quarter relative to the same quarter in the previous year. Although production volumes have increased, program revenue mix has remained consistent in 2017 relative to 2016 for production contracts manufactured out of the Delta facility. Revenue from the production and delivery for business jet programs has increased by approximately $894,000 as customer demand for the products has increased in 2017 over 2016. Defence programs' production also experienced a positive shift in production demand causing this revenue source to increase by approximately $2,618,000. While commercial aircraft production supply was increased by $214,000 in Q1 2017 as compared to Q1 2016 due to an increase in customer demand for discrete and lower complexity assembled structures.

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

For the quarter ending March 31, 2017, the Avcorp Group recorded losses from operations totaling $8,617,000 from $38,568,000 revenue, which include costs incurred and yet to be recovered under the Hitco acquisition agreement, as compared to $7,568,000 operating losses from $39,941,000 revenue for the same quarter in the previous year.

Certain product quality and warranty claims by customers arising from Hitco's deliveries made before the closing date of Hitco acquisition, although indemnified under the asset purchase agreement with Hitco and SGL, adversely impacted operations and caused excessive personnel costs, and administrative and legal expenditures at Avcorp's Gardena facility during the periods. These costs have yet to be recovered and are included in the expenses for 2017 and 2016.

The financial results presented for the quarter ended March 31, 2017 do not take into account any recovery provision for these operational expenditures for which the Company believes it is indemnified for under its asset purchase agreement, and ancillary agreements, with SGL. These expenditure recovery amounts are not finalized and cannot be practicably quantified at this time.

Operating losses due to production at the Gardena facility amounted to approximately $3,858,000 during the quarter ended March 31, 2017 (March 31, 2016: $4,263,000) which includes the amortization of the unfavourable contract liability of $2,636,000 into income (March 31, 2016: $6,889,000), due primarily to certain unfavourable customer contracts assumed with the December 18, 2015 Hitco acquisition. As well, the 2016 first quarter losses include costs from pre-existing operational inefficiencies at the Gardena facility, and losses from unexpected legacy product quality and warranty claim stemming from Hitco delivered product.

An unfavourable contract liability accruing for certain customer contracts, for which unavoidable costs are expected to exceed the corresponding revenue earned, amounted to $100,582,000 upon the Hitco acquisition; of which $53,776,000 remains unamortized as at March 31, 2017. The unfavourable contract liability is amortized into income as revenue on a units-of-production basis over the expected life of the contract and as costs are incurred. The amount of unfavourable contract liability amortized into income as revenue during the quarter ended March 31, 2017 was $2,636,000 (March 31, 2016: $6,069,000). The unamortized unfavourable contract liability is accrued in US dollars and therefore the unamortized balance will vary from quarter to quarter as the estimated provision is adjusted for foreign currency fluctuations.

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

Although recent customer contract awards will continue to increase facility utilization, there remains significant levels of unutilized plant capacity within the Company's Delta, British Columbia facility. The Company has expensed $1,121,000 of overhead costs during the quarter (March 31, 2016: $1,064,000) in respect of unutilized plant capacity. The amount of overhead costs expensed, as a result of unutilized capacity, will fluctuate from quarter to quarter as production in support of deliveries varies. Revenue growth in this facility would benefit Company profitability via a contribution 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 recent transition to composite manufacturing capabilities, further leveraging existing production capacity and investments.

During the quarter ended March 31, 2017, cash flows from operating activities, excluding the impact of changes in non-cash working capital, utilized $9,703,000 of cash as compared with utilization of $12,782,000 of cash during the quarter ended March 31, 2016. Cash flows from operating activities were most significantly impacted as a result of operating losses incurred from the integration and production costs expended for the acquired Hitco operations, losses arising from unfavourable customer contracts assumed, and operational, administrative, and legal expenditures, incurred at Avcorp's Gardena facility as a direct result of product quality and warranty claims on product delivered pre-Hitco acquisition.

Changes in non-cash working capital during the current year increased cash flows from operating activities by $9,327,000 (March 31, 2016: $7,498,000 decrease) primarily as the Company collected accounts receivable, extended payment terms to suppliers, and reduced inventories to lower operating levels.

Also, pursuant to the Hitco acquisition, the Company assumed a customer advance for pre-funding of product deliveries. The customer advance is re-paid as the Company delivers to its customer ordered products for a specific program. The customer advance is subject to an access and security agreement along with a general security agreement entered into with the Company's bank and the customer. The remaining unamortized customer advance has been discounted to arrive at the March 31, 2017 amount of $10,368,000 (December 31, 2016: $11,573,000) of which it is estimated $7,958,000 will be amortized during the next twelve months. The Company re-paid and amortized into income $1,088,000 of the customer advance during the quarter ended March 31, 2017 (March 31, 2016: $1,180,000).

As at March 31, 2017, the Company had $4,220,000 cash on hand (December 31, 2016: $3,960,000) and had utilized $17,631,000 of its operating line of credit (December 31, 2016: $17,111,000). The Company has a working capital deficit of $18,038,000 as at March 31, 2017 which has increased from the December 31, 2016 $5,439,000 deficit. Working capital surplus is defined as the difference between current assets and current liabilities. However, the Company's accounts receivable and inventories net of accounts payable amount to $24,811,000 as at March 31, 2017 (March 31, 2016: $38,399,000). The Company's accumulated deficit as at March 31, 2017 is $103,238,000 (December 31, 2016: $93,791,000).

ACF Gardena

The Gardena facility defence programs' transition by Avcorp have been successful and are continuing to meet customer delivery requirements, and have not experienced the extraordinary unanticipated issues relative to process quality and operational disruptions of ACF's commercial programs. The planned improvement initiatives for the defence programs, including the F-35 program for Lockheed Martin, continue and are performing as forecasted. This has resulted in an award of a follow-on contract from Lockheed Martin that was previously announced. Opportunities exist for ACF to deliver on unfilled customer orders for this program.

The start-up, post-acquisition of the ACF commercial operations in Gardena, faced several significant unanticipated challenges during 2016, which continued to have an adverse financial impact through to the first quarter of 2017 as the Company's operational turn around initiatives were significantly delayed. Operational losses incurred at the Gardena facility amounted to $3,858,000 for the quarter ended March 31, 2017. This included amortization of the unfavourable contract liability of $2,636,000 into income in 2017 (March 31, 2016: $6,889,000). Product quality and warranty claims on product delivered by Hitco pre-acquisition, although indemnified under the asset purchase agreement with Hitco and SGL, further adversely impacted operations and caused excessive personnel costs, and administrative and legal expenditures at ACF's Gardena facility during the periods. These costs have yet to be recovered and are included in all the costs for 2016.

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

The majority of the corrective actions commenced in the second quarter of 2016 which continued into the third and fourth quarters, will allow the Gardena operations to achieve fully contracted output levels. Avcorp's key commercial customers have worked collaboratively with Avcorp to mitigate production schedules risks and support the earliest resolution of the outstanding process and product issues.

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

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

Revenue

During the quarter ended March 31, 2017 Avcorp Group revenues totalled $38,568,000 compared with $39,941,000 revenue for the same quarter in the previous year; a 3% revenue decrease as compared to 2016. Revenues include the amortization and contract renegotiation of the unfavourable contract liability of $2,636,000 in 2017 (2016: $6,069,000).

Operating segment revenues are as follows:

REVENUE DISTRIBUTION

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

FOR THE QUARTER ENDED MARCH 31	**2017**		2016	
	Revenue	**% of Total**	Revenue	% of Total
Avcorp Industries Inc.	**$13,504**	**35.0**	$10,686	26.8
Comtek Advanced Structures Ltd.	**4,464**	**11.6**	5,633	14.1
Avcorp Composite Fabrication Inc.[1]	**20,600**	**53.4**	23,622	59.1
Total	**38,568**	**100.0**	39,941	100.0

1. ACF revenue includes amortization of the unfavourable contract liability of $2,636,000 in 2017 (March 31, 2016: $6,069,000).

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

Delta facility revenues, for all programs generated by legacy production contracts, have increased by $2,832,000 during the current quarter relative to the same quarter in the previous year. Although production volumes have increased, program revenue mix has remained consistent in 2017 relative to 2016 for production contracts manufactured out of the Delta facility. Revenue from the production and delivery for business jet programs has increased by approximately $894,000 as customer demand for the products has increased in 2017 over 2016. Defence programs' production also experienced a positive shift in production demand causing this revenue source to increase by approximately $2,618,000. While commercial aircraft production supply was increased by $214,000 in Q1 2017 as compared to Q1 2016 due to an increase in customer demand for discrete and lower complexity assembled structures.

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

The **Burlington facility** had a decline in the delivery of composite floor panels in supply to Bombardier Aerospace's Global 5000/6000 and Global 7000/8000 programs during the current quarter, with a decrease of 9% in production for these contracts in Q1 2017 versus Q1 2016 as the customer adjusted its inventory levels. Full rate production for these programs establishes the wholly owned subsidiary as a leading manufacturer of composite floor panels. Composite floor panel revenues arising from aftermarket or spare component sales increased slightly during Q1 2017 relative to Q1 2016 offsetting the Global 5000/6000 and Global 7000/8000 reduction in deliveries. While composite floor panel revenues derived from sales to original equipment manufacturers ("OEM") of regional aircraft decreased 27% during the same three month period; primarily as a result of a shift in customer demand. Composite aircraft repair revenues out of Comtek were $783,000 lower in the first quarter 2017 in comparison to the same quarter in 2016, as regional airline customers implement cost reduction initiatives and fleet aircraft mix changes. In summary, Avcorp's Burlington operations decreased revenue in 2017 relative to 2016 by $1,169,000.

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

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

2017 revenues arising from the assignment by customers of commercial aerospace contracts to Avcorp Industries Inc. in conjunction with the December 18, 2015 Hitco acquisition have generated $15,681,000 in revenue (March 31, 2016: $22,289,000). These contracts support customer production of commercial aircraft. Manufacturing of the composite parts occurs in Avcorp Group's **Gardena facility**. The Gardena facility was assigned defence aerospace contracts by Hitco's customers upon the finalization of the acquisition. These contracts generated $4,802,000 of revenue during the quarter ended March 31, 2017 for ACF (March 31, 2016: $3,281,000). Issues with deliveries of products and services within the Gardena production supply chain were the primary cause for this facility not to have delivered to available customer demand. The March 31, 2017 increase of the Company's existing credit facility with a Canadian chartered bank to USD$23,000,000 alleviated supply chain constraints and has since provided the necessary liquidity to commence normal operating conditions.

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

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

Revenues from Avcorp Group customers are as follows:

REVENUE DISTRIBUTION

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

FOR THE QUARTER ENDED MARCH 31	**2017**		2016	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$2,906**	**7.5**	$-	-
Boeing[1]	**13,779**	**35.7**	18,372	46.0
Bombardier	**4,916**	**12.7**	4,494	11.3
Lockheed Martin	**3,793**	**9.8**	1,905	4.8
Subaru Corporation (formerly Fuji Heavy Industries)	**5,227**	**13.6**	3,327	8.3
Other	**5,312**	**13.8**	5,774	14.5
Amortization and contract renegotiation of the unfavourable contract liability	**2,636**	**6.9**	6,069	15.1
Total	**38,568**	**100.0**	39,941	100.0

1. Includes Boeing program partner revenue.

The Avcorp Delta BC facility is the single source supplier for the F-35 CV-OBW assembly under contract with **BAE Systems ("BAES")**, and delivers directly to **Lockheed Martin**. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35 aircraft which allows for handling and storage of the aircraft on the aircraft-carrier's deck and hangers, while keeping its long-range and low-landing-speed flight characteristics. The CV-OBW is regarded as one of the more complex assemblies that the Canadian aerospace industry contributes to the F-35 program. Production demand for the F-35 CV-OBW has increased in 2017 relative to 2016. Production contracts have been secured through to March 2019, with discussions underway with the customer to secure constant production through to the second quarter of 2020. The Company announced that further to the contract award from Lockheed Martin announced on October 15, 2015 for the expanded scope on the F-35 CV-OBW, Avcorp has received a firm order for the remaining units in the next two production phases, referred to as Low Rate Initial Production ("LRIP") Nine and LRIP Ten. Avcorp's established New Product Introduction ("NPI") process will ensure the successful knowledge and skills transfer from Lockheed Martin, required for the intricate work of paint preparation and complex installation of control surfaces and systems such as the outboard leading edge flaps, ailerons, fairings and sub-systems. The delivery of the first shipset to Lockheed Martin's Final Assembly and Check Out facility in Fort Worth, Texas, USA was in August 2016, with subsequent confirmed orders extending out to 2018.

Avcorp's Gardena California facility provides substantial content for all three models of the F-35 fighter aircraft. Fabricated components include: wing skins, upper and lower, nacelles, access panels, and a strap component that serves as a structural backbone to the aircraft. Avcorp fabricates these complex structures through a combination of both automated robotic fiber placement and hand laid graphic fabric methods. Avcorp is under a multi-year contract with Lockheed Martin Corporation, who release order quantity and schedule requirements that coincide with their fiscal year. The current period of performance extends through May 1, 2018. Follow on contract value is anticipated, assuming acceptable quality and delivery performance. Revenues for this long-term defence program totalled $3,793,000 for the quarter ended March 31, 2017 (March 31, 2016: $1,905,000).

Shipments of large metallic assemblies to **Boeing Commercial Airplane Group ("Boeing")**, primarily for the 737 commercial jet program, decreased slightly (2%) during 2017 relative to 2016. Concurrently, deliveries of fabricated parts to Boeing decreased (23%) as customer demand for discrete and lower complexity assembled structures has been reduced. During 2016, Avcorp delivered its first significant quantity of shipsets of composite fabricated aerostructures parts for Boeing programs from its acquired Gardena production facility. 2017 revenues for these composite parts totalled $6,382,000 (March 31, 2016: $7,689,000). Total revenues generated for the Company from various Boeing Commercial aircraft programs amounted to $12,811,000 (March 31, 2016: $17,116,000). The Company also delivers components to **Boeing Defense, Space & Security ("Boeing DSS")** for the Chinook CH47 helicopter. During the quarter ended March 31, 2017 the Company generated $968,000 of revenues in supply to Boeing DSS, a decrease in revenues recorded for the same period in 2016 (March 31, 2016: $1,256,000) reflecting variances in timing of customer demand. The Avcorp Delta BC facility announced on October 26, 2015 that it has been awarded the production contract for the supply of Boeing 767-2C Panoramic Camera Fairings. Furthermore, the Delta facility was able to secure the production contract for the Boeing 767 Flap Track Fairings. Both new programs were in the production set-up phase during 2016 and are expected to generate revenues in 2017. The Company continues to work towards obtaining additional new contracts supporting Boeing commercial jet programs as well as other Boeing DSS defense programs.

Revenues from **Bombardier Aerospace ("Bombardier")** programs increased during the current quarter relative to the same quarter ended March 31, 2016. Shipments of large assemblies for the CL605 business jet program increased by 50% during the current quarter as demand for these products has increased relative to 2016; while the Company experienced an 11% decrease in its deliveries of composite floor panels to Bombardier, as Avcorp adjusted production to match Bombardier demand related to certain regional jet aircraft. Avcorp Group's primary source of revenues from Bombardier in 2017 will continue to be from components for the CL605 and CL850 business jets, composite floor panels for the CRJ and Q400 aircraft programs, as well as a sustained rate of production of composite floor panels for Bombardier's Global 5000/6000 and Global 7000/8000 programs.

Avcorp's deliveries to **Subaru Corporation ("Subaru")** (formerly Fuji Heavy Industries) of large complex composite structural components which are integrated into the centre wing box in support of the Boeing 787 commercial jet program totalled $5,227,000 for the current quarter (March 31, 2016: $3,327,000). This is a significant commercial production contract being manufactured in the Gardena facility. This long term agreement represents an important relationship with a long-standing industry tier one supplier.

Composite aircraft structure repair revenues out of Comtek were reduced as regional airline customers implement cost reduction initiatives and fleet aircraft mix changes, causing 2017 revenues to decrease 37% over revenues in the previous year. The Group also supplies Canadian aircraft retro-fit programs out of its Delta facility, and large composite structures in support of various US defense programs out of its Gardena facility. These Other revenues are of significant importance to the Group's operations as they generated $1,160,000 in revenue during the quarter ended March 31, 2017 (March 31, 2016: $843,000).

Defence program revenues for Avcorp during 2017 totalled $8,676,000 (March 31, 2016: $4,537,000); 22.5% of total revenues (March 31, 2016: 11.4%). **Commercial program revenues** continue to provide the majority of the Company's revenue (March 31, 2017: 70.9%; March 31, 2016: 75.4%) amounting to $27,349,000 for 2017 and $30,120,000 for the first quarter 2016. The Group continues to move forward with its revenue diversification between commercial and defence aerospace programs. Included in total revenues for the Company is the amortization and contract renegotiation of the unfavourable contract liability of $2,544,000 in 2017 (2016: $6,069,000).

Gross Profit

Gross profit (revenue less cost of sales) for the quarter ended March 31, 2017 was negative 7.5% of revenue compared to positive 1.5% of revenue for the quarter ended March 31, 2016. Included in the calculation of gross profit is the amortization of the unfavourable contract liability of $2,636,000 into income in 2017 (2016: $6,679,000). Exclusive of the unfavourable contract liability amortization into revenue, the negative gross profit for the first quarter 2017 would be $5,528,000 (March 31, 2016: $6,069,000).

The start-up, post-acquisition of the operations in Gardena, faced several unanticipated challenges during the first half of 2016. As a result of legacy quality issues raised by customers, a number of items were identified that required corrective action. These items accounted for substantial expenditures beyond normal production costs. Staffing levels during the third and fourth quarters 2016 for the Gardena facility continued to remain very high relative to production deliveries as the operations utilized production resources to implement customer supported corrective actions. Consequently, gross margin on production contracts manufactured out of the Gardena facility, inclusive of legacy operational deficiency rectification costs, amounted to negative $5,287,000 for the quarter ended March 31, 2017 (March 31, 2016:negative $9,813,000).

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

Delta and Burlington production contracts, which pre-existed the Hitco acquisition, produced a gross loss for the quarter ended March 31, 2017 of $240,000 as compared with a gross margin of $3,743,000 for the same quarter in 2016; a $3,983,000 decrease, primarily caused by decreases in customer demand for business jet and defence aircraft. The weakening of the Canadian dollar relative to the US dollar for the majority of the Delta commercial contracts continues to have a significant adverse impact on gross margins as a large portion of the programs' cost structure is denominated in US dollars. The recent shift in regional airline repairs schemes have caused Burlington gross margins to decrease in this market segment.

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $1,121,000 of overhead costs during the current quarter (March 31, 2016: $1,064,000) in respect of unutilized plant capacity.

Administration and General Expenses

As a percentage of revenue, administration and general expenses decreased to 14.7% for the quarter ended March 31, 2017 from 19.9% for the quarter ended March 31, 2016. In absolute terms, administration and general costs decreased by $2,298,000 during the quarter relative to the same quarter in the prior year. Legal and professional services incurred during the prior year quarter were substantial as the Company administers various contracts and agreements assigned from and ancillary to its asset purchase agreement with Hitco and Frankfurt-listed SGL, which became effective on December 18, 2015.

Foreign Exchange Gain or Loss

Avcorp Group recorded a $39,000 foreign exchange loss during the quarter ended March 31, 2017 (March 31, 2016: $270,000 gain) as a result of holding US dollar-denominated cash, receivables, payables and debt.

Earnings Before Interest, Taxes, Depreciation & Amortization

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

EBITDA was negative $6,927,000 for the quarter ended March 31, 2017 compared to negative EBITDA of $5,857,000 for the quarter ended March 31, 2016. Significant pre-existing operational deficiencies and excessive cost structure within the acquired Hitco operations have resulted in poor production contract performance and adversely affected Group earnings for 2016 and have continued through into the first half of 2017 as turn around initiatives for the Gardena facility were significantly deferred. Many corrective actions have been implemented. As legacy operational deficiencies are rectified, additional operational improvements were made in the second half of 2016 and into 2017, thereby allowing the Gardena operations to achieve fully contracted output levels. Avcorp's key commercial customers have worked collaboratively with Avcorp to mitigate production schedule risks and support the earliest resolution of the outstanding process and product issues.

Included in the calculation of EBITDA is the amortization of the unfavourable contract liability of $2,636,000 into income in 2017 (2016: $6,889,000).

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

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

The complexity and challenge of executing the production start-up and improvement plans for the Gardena operations increased from the pre-acquisition estimates. Avcorp has worked successfully with the commercial aerospace customers to update plans and commitments to ensure support for their programs and a return to purchase order schedules by the end of third quarter of 2016.

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

EBITDA[1]

(unaudited, expressed in thousands of Canadian dollars)

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Income loss for the year	**$(9,447)**	$(7,260)
Interest expense and financing charges	**778**	21
Income tax expense	**-**	-
Depreciation	**1,014**	860
Amortization of development costs and intangibles	**728**	522
	(6,927)	(5,857)

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

Finance Costs

Total interest and financing charges on both short- and long-term debt for the quarter ended March 31, 2017 were $776,000, net of $2,000 interest income (March 31, 2016: $9,000), compared with net $21,000 expense for the quarter ended March 31, 2016.

Income Taxes

Avcorp Group has not incurred a tax expense during the quarter ended March 31, 2017 (March 31, 2016: $Nil) nor recorded a tax benefit as it is not more likely than not that the benefit would be recognized.

Income or Loss

Loss for the quarter ended March 31, 2017 was $9,447,000 compared to a loss of $7,260,000 for the quarter ended March 31, 2016. Significant pre-existing operational deficiencies and excessive cost structure within the newly acquired Hitco operations have resulted in poor production contract performance and significantly adversely affected Group earnings; operational turn around initiatives, although delayed, have commenced.

Included in the calculation of loss is the amortization of the unfavourable contract liability of $2,636,000 into revenue in 2016 (2015: $6,889,000).

Liquidity and Capital Resources

At quarter end Avcorp Group's operating line of credit provides for a total utilization of USD$23,000,000. Avcorp Group ended the quarter with bank operating line utilization of $17,631,000 offset by $4,220,000 cash compared to utilization of $17,111,000 and $3,960,000 cash on hand at December 31, 2016. Based on net collateral provided to its bank, Avcorp Group is able to draw $18,077,000 on its operating line of credit as at March 31, 2017 (December 31, 2016: $21,000,000).

Effective February 17, 2017, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the bank extended the credit facility from April 15, 2017 to July 30, 2017.

Effective March 2, 2017, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the permanent block against available credit was reduced from $2,500,000 to $1,800,000.

Effective March 31, 2017 the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendments were made;

- the permanent block against available credit of $1,800,000 was removed;
- availability under the facility was increased to USD$23,000,000 subject to draw down provisions which have been amended to include eligible receivables and inventories of Avcorp Composite Fabrication Inc.; and
- the debt facility will bear interest at a rate equal to the bank's prime rate plus 0.75%.

On March 17, 2017, Avcorp entered into a loan agreement ("Loan") with Panta bearing interest of 8% per annum to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The Loan was repaid on April 4, 2017 from the proceeds of consideration receivable from the Hitco acquisition. Panta is Avcorp's majority shareholder owning approximately 65.5% of the issued and outstanding common shares on March 31, 2017. Panta is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

On April 3, 2017, Avcorp received the USD$9,220,000 remaining consideration receivable from the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc. USD$6,511,000 of the consideration payment was utilized to repay a portion of the debt facility with a Canadian Chartered bank. A further amount of USD$907,000 was utilized to repay the Loan with Panta.

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

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

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

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

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

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

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

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

The Expanded Loan 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.

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

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital, decreased by $9,703,000 during the quarter ended March 31, 2017 as compared to utilizing $12,782,000 of cash during the quarter ended March 31, 2016. Cash flows from operating activities were most significantly impacted as a result of operational losses incurred under customer contracts assigned with the December 18, 2015 Hitco acquisition.

Non-cash operating assets and liabilities provided $9,327,000 of cash during the current quarter, compared to utilizing $7,498,000 of cash during the same quarter in 2016; primarily from collection of accounts receivable, inventory sold during the period, as well as extended payment terms provided by certain suppliers. Avcorp Group continues to closely monitor accounts receivable and work with its customers in order to ensure cash is collected on a timely basis.

Cash Flows from Investing Activities

During the quarter ended March 31, 2017, the Avcorp Group purchased capital assets totalling $825,000 compared with $1,482,000 during the quarter ended March 31, 2016. Avcorp Group continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

During 2016 and 2017, the Company commenced the new program introduction process in support of the newly awarded production contracts. The start-up of new production contracts requires significant investments in hard and soft tooling. Such tooling investments amounted to $663,000 in the current quarter of 2017 (March 31, 2016: $1,044,000).

Cash Flows from Financing Activities

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

Cash flows from financing activities provided $1,569,000 of cash during the current quarter compared with utilizing $82,000 of cash in 2016. The Company's operating line was $17,631,000 drawn as at March 31, 2017 providing $520,000 in cash during the quarter (March 31, 2016: $Nil).

On March 17, 2017, Avcorp entered into a loan agreement with Panta Canada B.V. The loan was drawn down in two tranches on March 21, 2017 and March 27, 2017 and provided $1,213,000 of cash.

On March 31, 2017, the ratio of the Company's current assets to current liabilities was 0.83:1 (December 31, 2016: 0.95:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

(unaudited, expressed in thousands of Canadian dollars)

	Total	2017	2018 – 2020	2021 – 2022	Post 2022
Finance lease obligations	**$135**	$35	$100	$-	$-
Term loan	**8,282**	8,134	148	-	-
Other long-term obligations[1]	**1,410**	-	147	71	1,192
Purchase obligations[2]	**48,583**	43,716	4,858	9	-
Total contractual obligations	**58,410**	51,885	5,253	80	1,192

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

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

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

Capital Stock

As at March 31, 2017, there were 307,141,184 common shares, 60,977,436 common share purchase warrants, and 52,225,500 stock options issued and outstanding.

Common Shares

Panta Canada B.V., is 100% owned by Panta Holdings B.V. and is Avcorp's majority shareholder owning approximately 65.5% of issued and outstanding common shares as of March 31, 2017.

No common shares were issued by the Company during the first quarter 2017 and 2016.

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 307,141,184 common shares issued at March 31, 2017. The book value of common shares issued and outstanding as at March 31, 2017 was $80,302,000 (December 31, 2016: $80,302,000).

Accounting standards issued but not yet effective

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

IFRS 15 – Revenue from Contracts with Customers

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

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

This standard is required to be applied for accounting periods beginning on or after January 1, 2018, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 9 – Financial Instruments

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

IFRS 16 - Leases

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

IFRS 2 – Share Based Payments

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

IFRIC Interpretation 22 – Foreign Currency Transactions and Advance Consideration

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

Operations Overview

Delivery and Quality Performance

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

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

Order Backlog

Avcorp Group operates within "general terms agreements" with its customers. These agreements are typically for five years or longer.

The Company's agreements with Boeing Commercial Airplane Group extend from January 2013 to December 2017; additional production contracts entered into during 2015 and 2016 extend to 2028 and 2025 respectively. Production contracts underlying Boeing's general term agreements, which were assigned to Avcorp with the Hitco acquisition, extend to 2019.

Agreements with Boeing Defense, Space and Security extend from 2013 into 2019 with established minimum base delivery quantity requirements.

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

Agreements with Lockheed Martin extend into 2018, with negotiations occurring for follow-on orders to existing statements of work through to 2020.

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

The Company defines order backlog as the value of purchase orders it expects to receive from these agreements based on manufacturers' projections and current degrees of exclusivity. Order backlog is a financial measure not recognized as a term under IFRS. However, the Avcorp's management believes that the Company's stakeholders consider this metric to be useful information to assist them in evaluating profitability. The order backlog, as at March 31, 2017, is $785 million in consideration of attaining full award values, compared to $826 million as at December 31, 2016. The changes in order backlog are as follows:

- $39 million decrease in order backlog resulting from revenues recorded during the quarter ended March 31, 2017;
- $5 million increase in order backlog due to increases in the production rates, contract renewals for various existing programs, and contract awards; and
- $7 million decrease in order backlog resulting from change in the value of the Canadian dollar relative to the US dollar for the Company's US dollar denominated sales. Refer to comments on currency risk.

Supply Chain

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

During 2014 the company qualified certain suppliers in support of its in-house transition to increasingly value-added production processes. These suppliers support the Company by providing manufacturing capabilities, to which Avcorp has transitioned in 2015; the process is a critical cost reduction process which is continuing through 2017.

The capacity and delivery performance of a limited number of critical vendors continues to be closely monitored to mitigate risks to assembly start dates. Risk mitigation plans have been implemented. The securing of additional long-term contracts with key suppliers continues.

Working Capital Utilization

Total current assets less total current liabilities were in a deficit position of $18,038,000 at March 31, 2017 and $5,439,000 at December 31, 2016. Working capital decreased during 2017 as accounts receivable and inventories were reduced, offset by an increase in accounts payable.

Financial Resources

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

Non-Financial Resources

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

Human Resources

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

The number of employees at March 31, 2017 was 757 (December 31, 2016: 722). Employees have appropriate qualifications and experience to perform their duties and the Company provides ongoing training and opportunities for employee growth.

Equipment, Systems, Technologies and Processes

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

Risk Assessment

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

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

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

Additional Financing

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 newly acquired entities;
- finance new program development and introduction;
- develop or enhance existing services and capabilities; or
- respond to competitive pressures.

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

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

Customer Contracts

The Company is exposed to the risk that existing customer fixed-term contracts are not renewed at expiration date. Avcorp Group operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's agreements with Boeing CA extend from current date, with various expiry timelines, through to the end of 2028. Agreements with Boeing DSS have been renewed and established which extend from 2013 into 2019 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 FHI agreements extend for the life of the individual aircraft programs.

BAE and Lockheed Martin customer contracts extend into 2019. The Company is currently negotiating the extension of follow-on contracts.

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

Procured Materials and Parts

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

Aircraft Production Rates

The following industry and program trends impact the Company:

- Company research indicates that the aerostructures markets for commercial aircraft and larger business jets would continue to grow beyond 2016. The lighter business jets' market is expected to show modest growth.
- Growth in air travel rates has and will further increase production rates on the Boeing 737 and Airbus A320 platforms in the coming years. The regional aircraft market remains soft around current rates.
- Bombardier Challenger CL650 aircraft production requirements were reduced in 2016 relative to 2015. The 2017 CL650 production build has increased relative to 2016 and is forecasted to remain flat through 2020.
- The growth in the global market for defence aircraft although slowed, continued through 2016 with continued growth expected in 2017.
- The F-35 remains, on a global scale, one of the largest Defence Airplane programs for the foreseeable future.
- Offset opportunities created by Canadian Government procurement within military aerospace programs such as the Boeing F-18 and Airbus C295 FWSAR could lead to additional revenue opportunities from this aerospace sector.

Competitors

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

Cost Reductions

Approximately 62% of Avcorp Group's cost of sales is related to labour and overhead and 38% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its western European and north western United States competitors and higher than those in the south eastern United States, Asia, Eastern Europe and Mexico. On July 30, 2013 the labour force, at the Delta facility ratified a new six-year collective agreement. The agreement was ratified by a two-thirds majority, with the agreement expiring on March 31, 2019. Subsequent to the Hitco acquisition the Company and the labour force, in Gardena, agreed to a four month extension of the current collective agreement, which was to expire February 29, 2016. On June 29, 2016 the labour force at the Gardena facility ratified a new 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.

Composite Materials

Through its subsidiary Comtek, the Company has ongoing operations expertise in the design and competitive manufacture and repair of advanced composite aerostructures which provides the opportunity for the Company to compete in a market which is trending, with each new generation of aircraft, to greater use of composite material in primary structures. As well, the Company's Delta location is supplementing its current operations with composite qualification, leveraging existing production capacity and investments.

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

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

US Dollar Revenues

Avcorp Group sells a significant proportion of its products in US dollars, partially from its Canadian operations and entirely within its United States operations, at prices which are often established well in advance of manufacture and shipment dates. As the value of the Canadian dollar decreases, the equivalent value of US dollar denominated revenues increases; conversely, the cost of US dollar denominated purchases will increase. The Company is continuing to structure new agreements with customers which mitigate the risk associated with currency fluctuations. It should be noted that a significant portion of the Company's purchases of raw materials, supplier fabricated parts, as well as equipment purchases, are denominated in US dollars.

Outlook

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

Boeing is the Company's largest customer in 2017, followed by Subaru Corporation (formerly Fuji Heavy Industries), Bombardier, Lockheed Martin and BAE Systems. The Company forecasts its 2017 revenues to increase above 2016 levels as the Gardena facility programs reach full rates of production, and Delta ramps up production for newly awarded contracts.

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

On April 4, 2017, Avcorp received the USD$9,220,000 remaining consideration receivable from the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc. USD$6,511,000 of the consideration payment was utilized to repay a portion of the debt facility with a Canadian Chartered bank. A further amount of USD$907,000 was utilized to repay the Loan with Panta.

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

On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank ("the Expanded Loan"). This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012 (note 15). The Expanded Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at March 31, 2017, USD$23,000,000 revolving loan (note 33c) in total up to USD$58,000,000. The Expanded Loan matures on June 30, 2020.

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

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

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

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

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

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

The Expanded Loan 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 Lessor of the Industrial Centre at Gardena California, where Avcorp Composite Fabrication Inc. has its manufacturing facilities, received an offer from a third party to purchase the Industrial Centre. On March 28, 2017 Avcorp exercised its right of first refusal under the lease agreement by providing notice to the Lessor that it proposes to purchase the property on the same terms and conditions as presented in the Offer. Avcorp has up to 270 days from the date of providing such notice to present and close a sale transaction with the Lessor. Avcorp is not committed to purchase the property and is currently evaluating its options with respect to the property.

Transactions with Related Parties

During 2015 a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 65.5% of the issued and outstanding common shares on March 31, 2017. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee was calculated as a percentage of revenues generated from production contracts with this certain customer. This performance guarantee was extinguished as at December 18, 2015. Fees paid, in that respect, to Panta Holdings B.V. during the quarter ended March 31, 2017 amounted to $Nil (March 31, 2016: $330,000).

During the quarter ended March 31, 2017, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the quarter ended March 31, 2017 amounted to $392,000 (March 31, 2016: $53,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at March 31, 2017 are $Nil (March 31, 2016: $Nil). These fees are included in the Condensed Interim Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amount to $16,000 for the quarter ended March 31, 2017 (March 31, 2016: $41,000).

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

KEY MANAGEMENT COMPENSATION

(unaudited, expressed in thousands of Canadian dollars)

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Salaries and other short-term employee benefits	**$506**	$397
Contributions to defined contribution plan	**18**	14
Option-based awards	**199**	127
	723	538

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

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

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

In conjunction with receiving advances under the term loan, the Company issued Panta 30,714,118 common share purchase warrants ("warrants") on a pro-rata basis, each warrant is exercisable for a period of 24 months following the date of issuance with respect to one common share at an exercise price of $0.07 per common share. The Company issued 12,285,647 such warrants on September 23, 2016, 9,214,235 such warrants on October 25, 2016, and 9,214,236 such warrants on November 15, 2016. The warrants were valued at fair value on date of issue using the Black Scholes option pricing model.

On March 17, 2017, Avcorp entered into a loan agreement ("Loan") with Panta Canada B.V. ("Panta") bearing interest of 8% per annum to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The Loan was repaid on April 4, 2017 from the proceeds of the consideration receivable.

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

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

Business Acquisition

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

Through the Acquisition, Avcorp acquired the composite Aerostructures division of Hitco but did not acquire any assets of Hitco's materials division that is responsible for the production of specialty materials. The Acquisition included all of the assets, properties and rights held by Hitco related to the Business including:

- inventory, packaging materials, and consumables of the Business;
- fixed assets, equipment and tooling assets primarily used in the Business;
- accounts or notes receivable related to the Business;
- prepaid expenses and deposits primarily related to the Business;
- the intellectual property of the Business together with all of the goodwill associated with the intellectual property;
- the goodwill related to the Business, together with the exclusive right to hold Avcorp out as carrying on the Business in succession to Hitco;

- the right to use the name "Hitco Carbon Composites" or any variation thereof in connection with the Business; and
- several purchase contracts held by Hitco.

The Acquisition excluded any real property owned by Hitco and all assets of Hitco not related to the Business, including assets related to Hitco's business division that produces specialty materials.

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

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

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

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

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

Critical Accounting Estimates and Judgment

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

- Functional currency: The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which each operates. The Company has determined that the functional currency for the Company and all its subsidiaries except for Avcorp US Holdings Inc. and Avcorp Composite Fabrication Inc. is the Canadian dollar. The functional currency for Avcorp US Holdings Inc. and Avcorp Composite Fabrication Inc. is the US dollar. The determination of functional currency may require certain judgements to determine the primary economic environment. The Company reconsiders the functional currency used when there is a change in events and conditions which determined the primary economic environment.
- Impairments: The recoverable amount of intangible assets, development costs and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each CGU or group of CGUs. In order to estimate the fair value of indefinite-lived intangible assets and goodwill resulting from business combinations, the Company typically estimates future revenue, considers market factors and estimates future cash flows. Based on these key assumptions, judgments and estimates, the Company determines whether to record an impairment charge to reduce the value of the asset carried on the consolidated statement of financial position to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Company's business strategy or internal forecasts. Although the Company believes the assumptions, judgments and estimates made in the past have been reasonable and appropriate, different assumptions, judgments and estimates could materially affect the Company's reported financial results.
- Going Concern: Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.
- Capitalization of development costs: When capitalizing development costs the Company must assess the technical and commercial feasibility of the projects and estimate the useful lives of resulting products. Determining whether future economic benefits will flow from the assets and therefore the estimates and assumptions associated with these calculations are instrumental in (i) deciding whether project costs can be capitalized, and (ii) accurately calculating the useful life of the projects for the Company.

- Unfavorable contracts liability: At the acquisition date valued the unfavorable contracts liability at fair value using certain assumptions that would arise in a market participant view. The Company estimates the expected shipsets or production when assessing the liability, together with the discounts rate and period of performance under the varying contracts and service agreements. The cash flows are discounted over the period of performance using a discount rate commensurate with the risk associated with the liability.
- Fair value of assets and liabilities acquired in a business combination: The Company accounted for the acquisition of ACF using the acquisition method when control is transferred to the Company. The consideration received is generally measured at fair value, as are the identifiable net liabilities assumed. The fair value of the liabilities assumed is determined using valuation techniques that require estimation of the estimated cash flows, discount rates and estimated operating margins.
- Inventories are valued at the lower of cost and net realizable value. The costs of inventory involve estimates in determining the allocation of fixed and variable production overhead. These estimates involved include determination of normal production capacity and nature of expenses to be allocated. Additionally inventory is reviewed monthly to ensure the carrying value does not exceed net realizable value. If so, a write-down is recognized. The write-down may be reversed if the circumstances which caused it no longer exist.

Financial Instruments and Other Instruments

Market Risk

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

Currency Risk

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

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials and components in US dollars at prices that are usually established at the order date. The Company's operations are based in Canada and in the US. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange loss recorded was $65,000 for the quarter ended March 31, 2017 as compared to a $270,000 gain for the quarter ended March 31, 2016.

The Company had the following US dollar denominated balances:

CURRENCY RISK

(unaudited, expressed in thousands of US dollars)

FOR THE QUARTER ENDED MARCH 31	2017	2016
Bank cash position	**US$1,559**	US$6,748
Accounts receivable	**10,872**	19,763
Consideration receivable	**8,739**	13,739
Accounts payable net of prepayments	**3,246**	2,282
Customer advance	**7,796**	12,530
Bank indebtedness	**6,250**	-
Term debt	**6,054**	-

With other variables unchanged, each $0.10 strengthening (weakening) of the US dollar against the Canadian dollar would result in an increase (decrease) of approximately $218,000 in net income for the quarter ended March 31, 2017 (March 31, 2016: $2,544,000 increase (decrease) in net income) as a result of holding a US dollar net asset position.

Credit Risk

Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group ("Boeing"), Boeing Defense, Space & Security ("BDS"), Bombardier Aerospace ("Bombardier"), BAE Systems (Operations) Limited ("BAE"), Lockheed Martin ("LM"), and Subaru Corporation ("Subaru") (formerly Fuji Heavy Industries Ltd.). 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 72.2% (March 31, 2016: 76.1%) of the Company's trade accounts receivable are attributable to these customers.

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

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

Liquidity Risk

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

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

The Company's operating line of credit is due on demand.

Interest Rate Risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 0.5%. The maximum operating line of credit availability is $21,000,000 of which $17,631,000 is utilized as at March 31, 2017 (March 31, 2016: $Nil). The Company lowers interest rate costs by managing utilization of the operating lines of credit to the lowest amount practical. For the quarter ended March 31, 2017, with other variables unchanged, a 1% change in the bank prime interest rate would have a $44,000 (March 31, 2016: $Nil) impact on net earnings and cash flow.

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

Capital Risk

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

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

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

Other Items

Disclosure Controls and Procedures, and Internal Controls over Financial Reporting

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

The Chief Executive Officer and the Chief Financial Officer have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of March 31, 2017 and concluded that the Company's current disclosure controls and procedures as well as the internal controls over financial reporting are effective. There were therefore no changes to the Company's disclosure controls and procedures, or in the design of internal controls over financial reporting, during the quarter ended March 31, 2017, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

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

report of **management**

The accompanying condensed interim consolidated financial statements of Avcorp Industries Inc. and all other information contained in the Management Discussion and Analysis are the responsibility of management. The condensed interim consolidated financial statements were prepared in conformity with IAS 34 Interim Financial Reporting ("IAS 34") appropriate in the circumstances, in a manner consistent with the previous quarter, and include some amounts based on management's best judgments and estimates. The financial information contained elsewhere in this Management Report and Analysis is consistent with that in the interim condensed interim consolidated financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance. As at the end of the period covered by this report, the system of internal control provides reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with IAS 34. 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.

The accompanying condensed interim consolidated financial statements of Avcorp Industries Inc. ("the Company") have been prepared by and are the responsibility of the Company's management. The independent Auditor of the Company has not performed a review of these condensed interim consolidated financial statements.

	EDWARD MERLO Chief Financial Officer and Corporate Secretary		**PETER GEORGE** Executive Officer and Group Chief Executive Officer

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited, expressed in thousands of Canadian dollars)

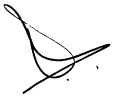
	March 31, 2017	December 31, 2016
ASSETS		
Current assets		
Cash (note 12)	**$4,220**	$3,960
Accounts receivable (note 5)	**21,522**	26,262
Consideration receivable (note 6)	**12,263**	12,251
Inventories (note 7)	**41,311**	44,259
Prepayments and other assets (note 8)	**5,045**	4,144
	84,361	90,876
Non-current assets		
Prepaid rent and security	**146**	146
Development costs (note 9)	**5,466**	5,200
Property, plant and equipment (note 10)	**31,466**	31,930
Intangibles (note 11)	**4,508**	4,887
Total assets	**125,947**	133,039
LIABILITIES AND EQUITY		
Current liabilities		
Bank indebtedness (note 12)	**17,631**	17,111
Accounts payable and accrued liabilities (note 14)	**38,022**	32,122
Current portion of term debt (note 17)	**8,210**	6,283
Customer advance (note 13)	**7,958**	8,034
Deferred program revenues (note 15)	**12,144**	13,861
Unfavourable contracts liability (note 15)	**18,434**	18,904
	102,399	96,315
Non-current liabilities		
Deferred gain and lease inducement	**209**	246
Term debt (note 17)	**1,617**	1,646
Customer advance (note 13)	**2,410**	3,539
Unfavourable contracts liability (note 16)	**35,342**	38,065
Deferred program revenues (note 15)	**81**	111
	142,058	139,922
(Deficiency) Equity		
Capital stock (note 18)	**80,302**	80,302
Contributed surplus	**6,961**	6,744
Accumulated other comprehensive loss	**(136)**	(138)
Accumulated deficit	**(103,238)**	(93,791)
	(16,111)	(6,883)
Total liabilities and (deficiency) equity	**125,947**	133,039

Nature of operations and going concern (note 1)
Subsequent events (note 24)

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

Approved by the Board of Directors on June 29, 2017

David Levi
Chairman



Eric Kohn TD
Committee Chair, Audit & Corporate Governance Committee

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

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

FOR THE QUARTER ENDED MARCH 31	2017	2016 restated (note 23)
Revenues (notes 16 and 22)	**$38,568**	$39,941
Cost of sales (note 3)	**41,460**	39,331
Gross (loss) profit	**(2,892)**	610
Administrative and general expenses (note 3)	**5,655**	7,953
Office equipment depreciation (note 3)	**70**	225
Operating Loss	**(8,617)**	(7,568)
Finance costs – net (note 19)	**776**	12
Foreign exchange loss (gain)	**39**	(270)
Net loss (gain) on sale of equipment	**15**	(50)
Loss before income tax	**(9,447)**	(7,260)
Income tax expense	**-**	-
Net loss for the period	**(9,447)**	(7,260)
Other comprehensive loss (income)	**2**	(487)
Net loss and total comprehensive loss for the period	**(9,445)**	(6,773)
Loss per share:		
Basic and diluted loss per common share (note 21)	**(0.03)**	(0.02)
Basic and diluted weighted average number of shares outstanding (000's) (note 21)	**307,141**	305,555

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, expressed in thousands of Canadian dollars)

FOR THE QUARTER ENDED MARCH 31	2017	2016 Restated (note 23)
Cash flows from (used in) operating activities		
Net loss for the period	**$(9,447)**	$(7,260)
Adjustment for items not affecting cash:		
Interest expense	**245**	20
Depreciation	**1,014**	860
Development cost amortization	**397**	153
Intangible assets amortization	**331**	369
Non-cash financing cost accretion	**536**	-
Gain on disposal of equipment	**15**	(50)
Provision for unfavourable contracts	**(2,636)**	(6,889)
Provision for doubtful accounts	**-**	204
Provision for obsolete inventory	**85**	31
Stock based compensation	**216**	(187)
Unrealized foreign exchange	**(442)**	-
Other items	**(17)**	(33)
Cash flows (used in) operating activities before changes in non-cash working capital	**(9,703)**	(12,782)
Changes in non-cash working capital		
Accounts receivable	**3,914**	(2,779)
Inventories	**2,626**	(2,954)
Prepayments and other assets	**(354)**	(53)
Accounts payable and accrued liabilities	**6,103**	(1,118)
Customer advance payable	**(1,205)**	(1,136)
Deferred program revenues	**(1,757)**	542
Net cash (used in) operating activities	**(376)**	(20,280)
Cash flows (used in) from investing activities		
Proceeds from consideration receivable	**-**	19,551
Proceeds from sale of equipment	**20**	50
Purchase of equipment	**(825)**	(1,482)
Payments relating to development costs and tooling	**(663)**	(1,044)
Net cash (used in) from investing activities	**(1,468)**	17,075
Cash flows from (used in) financing activities		
Increase in bank indebtedness	**520**	-
Payment of interest	**(125)**	(8)
Proceeds from term debt	**1,213**	31
Repayment of term debt	**(39)**	(105)
Net cash from (used in) financing activities	**1,569**	(82)
Net (decrease) in cash	**(275)**	(3,287)
Net foreign exchange difference	**535**	(704)
Cash - Beginning of the period	**3,960**	14,484
Cash - End of the period	**4,220**	10,493

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

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

	Capital Stock					
	Number of Shares	**Amount**	**Contributed Surplus**	**Deficit**	**Accumulated Other Comprehensive Income**	**Total Deficiency**
Balance December 31, 2015	305,555,184	80,158	4,453	(77,827)	-	6,784
Stock-based compensation expense	-	-	233	-	-	233
Forfeiture of issued stock options	-	-	(420)	-	-	(420)
Unrealized currency gain on translation for the period	-	-	-	-	487	487
Net loss for the period	-	-	-	(7,260)	-	(7,260)
Balance March 31, 2016 – restated (note 23)	**305,555,184**	**80,158**	**4,266**	**(85,087)**	**487**	**(176)**
Balance December 31, 2016	307,141,184	80,302	6,744	(93,791)	(138)	(6,883)
Stock-based compensation expense	-	-	217	-	-	217
Unrealized currency gain on translation for the period	-	-	-	-	2	2
Net loss for the period	-	-	-	(9,447)	-	(9,590)
Balance March 31, 2017	**307,141,184**	**80,302**	**6,961**	**(103,238)**	**(136)**	**(16,111)**

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

1. Nature of Operations

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

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

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

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

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

The condensed interim consolidated financial statements of the Company for the quarter ended March 31, 2017 were authorized for issue in accordance with a resolution of its Board of Directors on June 29, 2017.

During the quarter ended March 31, 2017, the Company incurred a net loss of $9,447,000 (March 31, 2016: $7,260,000), had negative operating cash flows of $376,000 (December 31, 2016: $20,280,000) and a shareholders' deficiency of $16,111,000 as of March 31, 2017. Management assesses the Company's ability to continue as a going concern at each reporting date, using all quantitative and qualitative information available. Material uncertainties have been identified which may cast significant doubt upon the Company's ability to continue as a going concern. This assessment, by its nature, relies on estimates of future cash flows and other future events, whose subsequent changes would materially impact the validity of such an assessment.

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

- On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank ("the Expanded Loan"). This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012 (note 12). The Expanded Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at March 31, 2017, USD$23,000,000 revolving loan (note 24c) in total up to USD$58,000,000. The Expanded Loan matures on June 30, 2020.
- As demonstrated throughout the year ended December 31, 2016 and the first quarter of fiscal 2017 the Company has worked closely with Panta Canada B.V., its parent company, to provide short term financing to meet peak financing needs.

The Company, in conjunction with is Board of Directors' Finance Sub-Committee, is also implementing various operational strategies which include:

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

Management believes that based on the Expanded Loan, and various operating and contract improvements which have been implemented, the Company will be in a position to meet its obligations as they come due.

The assessment of the Company's ability to execute its strategy of reducing operating costs and funding future working capital requirements involves significant judgement. Estimates and assumptions regarding future operating costs, revenue and profitability levels and general business and customer conditions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. After taking into account the above factors, management believes that they have adequate resources to meet the Company's obligations for the foreseeable future.

2. Basis of Preparation and Measurement

The condensed interim consolidated financial statements of the Company have been prepared in accordance with IAS 34 – Interim Financial Reporting ("IAS 34"). Certain information and note disclosures normally included in the audited annual consolidated financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") have been omitted or condensed. As a result, these condensed interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2016 ("Annual Financial Statements").

The condensed interim consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments that have been measured at fair value. The condensed interim 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:

IFRS 15 – Revenue from Contracts with Customers

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

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

This standard is required to be applied for accounting periods beginning on or after January 1, 2018, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 9 – Financial Instruments

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

IFRS 16 - Leases

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

IFRS 2 – Share Based Payments

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

IFRIC Interpretation 22 – Foreign Currency Transactions and Advance Consideration

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

3. Expenses by Nature

The Condensed Interim Consolidated Statements of Loss and Comprehensive Loss presents expenses by function. Accordingly, amortization and depreciation is not presented as a separate line on the statement, but is included within cost of sales to the extent that it relates to manufacturing machinery and equipment, as well as leasehold improvements.

Expenses by nature:

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Salary, wages and benefits	**$18,396**	$20,786
Raw materials, purchased parts and consumables	**18,221**	17,473
Contracted services and consulting	**2,187**	2,923
Other expenses and conversion of costs into inventory	**1,885**	590
Plant equipment rental and maintenance	**1,197**	1,118
Depreciation	**1,014**	860
Utilities	**897**	1,210
Rent	**735**	848
Transportation	**516**	579
Legal and audit fees	**496**	132
Amortization of development costs	**397**	153
Amortization of intangible assets	**331**	369
Travel costs	**321**	414
Office equipment rental/maintenance	**303**	422
Insurance	**160**	304
Royalties	**78**	56
Office suppliers	**51**	92
	47,185	48,329

4. Fair Value Measurement

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

	March 31, 2017		December 31, 2016	
	Carrying value	**Fair value**	Carrying value	Fair value
Financial liabilities				
Term debt	**$1,617**	**$1,617**	$1,646	$1,646

Fair value hierarchy

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

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

5. Accounts Receivable

	March 31, 2017	December 31, 2016
Trade receivables	**$20,130**	$24,205
Input tax credits	**1,276**	1,887
Accrued receivables	**116**	170
	21,522	26,262

The average trade receivables days outstanding is 50 days as at March 31, 2017 (March 31, 2016: 58 days; the March 31, 2016 trade receivables days outstanding does not include assumed trade receivables from the December 18, 2015 acquisition of Hitco).

The carrying amount of accounts receivable pledged as security under the Company's operating line of credit (note 12) as at March 31, 2017 is $18,065,000 (December 31, 2016: $23,325,000).

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

	March 31, 2017	December 31, 2016
US dollar	**US$13,184**	US$16,592
Canadian dollar	**3,967**	3,986

6. Consideration Receivable

On December 18, 2015, in conjunction with the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc., a subsidiary of Frankfurt-listed SGL Carbon SE ("Hitco") (note 23), Avcorp received $32,826,000 (USD$23,540,000) in cash consideration with $12,251,000 (USD$9,220,000 undiscounted) consideration receivable as at December 31, 2016. The consideration receivable as at March 31, 2017 on a discounted basis is $12,263,000 (December 31, 2016: USD$9,220,000 undiscounted). The consideration receivable took the form of:

- Avcorp received $5,864,000 (USD$4,237,000) in cash from SGL, the parent company of Hitco on January 4, 2016 in payment of past due trade payables assumed by Avcorp on acquisition close date;
- Avcorp received $14,048,000 (USD$10,000,000) in cash from SGL, the parent company of Hitco on January 31, 2016;
- Avcorp received $2,517,000 (USD$1,971,000) in cash from SGL, the parent company of Hitco on August 24, 2016. Avcorp extinguished another $3,867,000 (USD$3,029,000) of the consideration receivable through expenses and payments that SGL paid on Avcorp's behalf; and
- Avcorp received $12,378,000 net in cash from SGL, parent company of Hitco on April 4, 2017 (note 24a). The USD$9,220,000 undiscounted gross consideration receivable is guaranteed by SGL as well as a Canadian chartered bank.

	March 31, 2017	December 31, 2016
Opening balance	**$12,251**	$38,720
Receipts	**-**	(26,296)
Accretion	**127**	510
Foreign exchange	**(115)**	(683)
	12,263	12,251

7. Inventories

	March 31, 2017	December 31, 2016
Raw materials	**$19,432**	$21,121
Work-in-progress	**22,616**	25,696
Finished products	**4,585**	4,495
Inventory obsolescence	**(5,322)**	(7,053)
	41,311	44,259

The amount of inventory expensed in cost of sales during the quarter ended March 31, 2017 amounted to $40,533,000 (March 31, 2016: $37,288,000). The carrying value of inventory pledged as security under the Company's operating line of credit (note 12) as at March 31, 2017 is $20,772,000 (December 31, 2016: $20,828,000).

On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. The March 31, 2017 provision for anticipated losses was $38,000 (December 31, 2016: $37,000). Work in progress inventory noted in the above table has been presented net of these provisions for anticipated losses.

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

8. Prepayments and Other Assets

	March 31, 2017	December 31, 2016
Deposits on material purchases	**$1,616**	$461
Prepaid insurance	**1,380**	1,608
Prepaid IT security maintenance and licenses	**1,257**	1,029
Prepaid other	**572**	641
Prepaid property tax	**220**	405
	5,045	4,144

9. Development Costs

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

	March 31, 2017	December 31, 2016
Opening balance	**$5,200**	$3,187
Additions	**663**	2,617
Amortization	**(397)**	(604)
	5,466	5,200

	March 31, 2017	December 31, 2016
Cost	**$11,844**	$11,180
Accumulated amortization	**(6,378)**	(5,980)
Net book amount	**5,466**	5,200

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

10. Property, Plant and Equipment

	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
Year ended December 31, 2016				
Opening net book amount	28,048	1,066	526	29,640
Additions	5,827	386	623	6,836
Disposals – cost	(86)	(43)	-	(129)
Disposals – accumulated depreciation	76	8	-	84
Depreciation charge	(3,259)	(460)	(196)	(3,915)
Currency translation adjustment	(582)	(4)	-	(586)
Closing net book amount	30,024	953	953	31,930
At December 31, 2016				
Cost	57,180	8,065	1,975	67,220
Accumulated depreciation	(27,156)	(7,112)	(1,022)	(35,290)
Net book amount	30,024	953	953	31,930
Quarter ended March 31, 2017				
Opening net book amount	30,024	953	953	31,930
Additions	406	391	28	825
Disposals – cost	(40)	-	-	(40)
Disposals – accumulated depreciation	4	-	-	4
Depreciation charge	(870)	(67)	(77)	(1,014)
Currency translation adjustment	(235)	(4)	-	(239)
Closing net book amount	29,289	1,273	904	31,466
At March 31, 2017				
Cost	57,220	8,449	1,997	67,666
Accumulated depreciation	(27,931)	(7,176)	(1,093)	(36,200)
Net book amount	29,289	1,273	904	31,466

The Company has $405,000 in commitments at March 31, 2017 (December 31, 2016: $67,000) to purchase property, plant and equipment in 2017.

Included in computer hardware and software are assets held under finance leases at a cost of $24,000 (December 31, 2016: $24,000) having accumulated depreciation of $11,000 (December 31, 2016: $10,000).

Included in machinery and equipment are assets held under finance leases at a cost of $237,000 (December 31, 2016: $237,000) having accumulated depreciation of $44,000 (December 31, 2016: $38,000).

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

11. Intangibles

	Lease	Customer contract – re-compete	Total
Year ended December 31, 2016			
Opening net book amount	748	5,674	6,422
Amortization charge	(239)	(1,086)	(1,325)
Currency translation adjustment	(26)	(184)	(210)
Closing net book amount	483	4,404	4,887
At December 31, 2016			
Cost	725	5,505	6,230
Accumulated depreciation	(242)	(1,101)	(1,343)
Net book amount	483	4,404	4,887
Quarter ended March 31, 2017			
Opening net book amount	483	4,404	4,887
Amortization charge	(60)	(271)	(331)
Currency translation adjustment	(5)	(43)	(48)
Closing net book amount	418	4,090	4,508
At March 31, 2017			
Cost	717	5,453	6,170
Accumulated amortization	(299)	(1,363)	(1,662)
Net book amount	418	4,090	4,508

12. Bank Indebtedness

On September 27, 2012 the Company entered into a loan agreement with a Canadian chartered bank for a $12,000,000 principal amount secured debt facility. The debt facility bears interest at a rate equal to the bank's prime rate plus 0.5%.

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

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

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

On June 23, 2016, the Company's bank extended its banking agreement from June 30, 2016 to December 31, 2016.

Effective November 11, 2016, the Company entered into an amendment to its existing facility whereby the bank extended the term of the credit facility from December 31, 2016 to April 15, 2017, and, increased the maximum availability to $21,000,000, subject to existing draw down provisions and margining calculations, which may reduce the credit available. The additional credit availability was provided utilizing certain consideration receivable as security and which maximum availability was reduced upon collection of such certain consideration receivable (note 6).

Effective February 17, 2017, the Company entered into another amendment to its existing facility whereby the bank extended the credit facility from April 15, 2017 to July 30, 2017.

Effective March 2, 2017, the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the permanent block against available credit was reduced from $2,500,000 to $1,800,000.

Effective March 31, 2017 the Company entered into an amendment to its existing credit facility with a Canadian chartered bank whereby the following amendments were made;

- the permanent block against available credit of $1,800,000 was removed.
- availability under the facility was increased to USD$23,000,000 subject to draw down provisions which have been amended to include eligible receivables and inventories of Avcorp Composite Fabrication Inc.
- the debt facility will bear interest at a rate equal to the bank's prime rate plus 0.75%.

On May 26, 2017, the Company entered into a loan agreement to expand its existing facility to provide for an additional borrowing capacity of up to USD$35,000,000 until June 30, 2020 (note 24).

The Company ended the quarter with bank operating line utilization of $17,631,000 offset by $4,220,000 cash compared to utilization of $17,111,000 with $3,960,000 cash on hand as at December 31, 2016. Based on net collateral provided to its bank, the Company was able to draw up to an additional $763,000 on its operating line of credit as at March 31, 2017 (December 31, 2016: $4,901,000).

13. 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. 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.

The remaining unamortized customer advance has been discounted to arrive at the March 31, 2017 amount of $10,368,000 (December 31, 2016: $11,573,000) of which it is estimated $7,958,000 (December 31, 2016: $8,034,000) will be amortized during the next twelve months. The Company amortized into revenue $1,088,000 of the customer advance during the quarter ended March 31, 2017 (March 31, 2016: $1,180,000).

	March 31, 2017	December 31, 2016
Opening balance	**$11,573**	$18,528
Amortization	**(1,088)**	(6,287)
Foreign exchange	**(117)**	(668)
	10,368	11,573
Less: Current portion	**7,958**	8,034
Non-current portion	**2,410**	3,539

14. Accounts Payable and Accrued Liabilities

	March 31, 2017	December 31, 2016
Trade payables	**$30,982**	$24,835
Payroll-related liabilities	**5,786**	5,793
Restructuring provision	**145**	371
Other	**1,109**	1,123
	38,022	32,122

15. Deferred Program Revenues

	March 31, 2017	December 31, 2016
Opening balance	**$13,972**	$4,924
Additions	**1,206**	15,043
Realized	**(2,953)**	(5,995)
	12,225	13,972
Less: Current portion	**12,144**	13,861
Non-current portion	**81**	111

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

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

16. Unfavourable Contracts Liability

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

As at March 31, 2017, the remaining unamortized unfavourable contracts liability amounted to $53,776,000 (December 31, 2016: $56,969,000).

	March 31, 2017	December 31, 2016
Opening net book amount	**$56,969**	$99,471
Amortization and contract renegotiation	**(2,636)**	(38,937)
Foreign exchange	**(557)**	(3,565)
Closing net book amount	**53,776**	56,969
Less: Current portion	**18,434**	18,904
Non-current portion	**35,342**	38,065

The result of the renegotiation of certain contract delivery requirements was a reduction of future delivery commitments. Management performed a cumulative catch-up revenue adjustment of $7,792,000 in 2016 further reducing the provision as at December 31, 2016. The remaining provision is to be amortized over the reduced contractual life of the contract. The effect of this adjustment is to adjust the per unit amortization charge of finished goods already shipped to reflect the updated amortization charge per unit had the amended agreement existed as at the commencement date of the contract.

17. Term Debt

	March 31, 2017	December 31, 2016
Finance leases (a)	**$135**	$147
Term loans (b) (c)	**8,282**	6,384
SADI (d)	**1,410**	1,398
	9,827	7,929
Less: Current portion	**8,210**	6,283
Non-current portion	**1,617**	1,646

a) Finance Leases

There are various equipment leases that have a weighted average interest rate of 7.61% per annum (2016: 7.60%). The leases are secured by way of a charge against specific assets. The leases are repayable in equal installments over periods up to 60 months.

b) Term Loan

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

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 65.5% of the issued and outstanding common shares on March 31, 2017. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

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

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

	March 31, 2017	December 31, 2016
Opening balance	**$6,123**	$6,617
Accrued interest	**107**	87
Less: Fair value of warrants issued	**-**	(1,164)
Add: Foreign exchange gain	**55**	42
Accretion	**663**	541
	6,838	6,123

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

c) Term Loan

On March 17, 2017, Avcorp entered into a loan agreement ("Loan") with Panta Canada B.V. ("Panta") bearing interest of 8% per annum to fund the Company to a maximum aggregate principal amount of USD$907,000 maturing on May 15, 2017. The Loan was drawn down in two tranches dated March 21, 2017 and March 27, 2017. The Loan was repaid on April 3, 2017 from the proceeds of the consideration receivable as set out in note 24. Panta Canada B.V. is Avcorp's majority shareholder owning approximately 65.5% of the issued and outstanding common shares on December 31, 2016. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson, a director of the Company, is the sole shareholder of Panta Holdings B.V.

d) SADI

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

The contribution agreement has the following terms:

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

$1,410,000 was drawn on this facility as at March 31, 2017 (December 31, 2016: $1,398,000).

18. Capital Stock

No common shares were issued by the Company during the first quarter 2017 and 2016.

19. Finance Costs

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Interest on finance leases	**$3**	$5
Interest on other term debt	**15**	16
Interest on bank indebtedness	**117**	-
Interest on related party debt	**107**	-
Non-cash financing cost accretion	**536**	-
Interest expense	**778**	21
Interest income	**(2)**	(9)
Net interest expense	**776**	12

20. Related Party Transactions

a) During 2015 a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 65.5% of the issued and outstanding common shares on March 31, 2017. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee was calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees varied with fluctuations in sales to this certain customer. This performance guarantee was extinguished as at December 18, 2015. Fees paid, in that respect, to Panta Holdings B.V. during the quarter ended March 31, 2017 amounted to $Nil (March 31, 2016: $330,000).

b) During the quarter ended March 31, 2017, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the quarter ended March 31, 2017 amounted to $392,000 (March 31, 2016: $53,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at March 31, 2017 are $Nil (March 31, 2016: $Nil). These fees are included in the Condensed Interim Consolidated Statements of Loss and Comprehensive Loss as administrative and general expenses and amount to $16,000 for the quarter ended March 31, 2017 (March 31, 2016: $41,000).

c) Key management compensation

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

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Salaries and other short-term employee benefits	**$506**	$397
Contributions to defined contribution plan	**18**	14
Option-based awards	**199**	127
	723	538

d) Loans to related parties

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

Other related party transactions are disclosed elsewhere in these condensed interim consolidated financial statements (notes 17b and c).

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

21. Earnings per share

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

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

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

FOR THE QUARTER ENDED MARCH 31	**2017**	2016
Weighted average number of common shares for basic earnings per share	**307,141**	305,555
Effect of dilution:		
Warrants	**-**	-
Share options	**-**	-
Weighted average number of ordinary shares adjusted for the effect of dilution	**307,141**	305,555

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

22. 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 Executive Management Committee monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss and is measured consistently with operating profit or loss in the Condensed Interim Consolidated Statements of Loss and Comprehensive Loss.

a) Sales to five major customers for the quarter ended March 31, 2017 (March 31, 2016: top four major customers), which comprise several programs and contracts, accounted for approximately 79.3% (March 31, 2016: 70.4%) of sales.

FOR THE QUARTER ENDED MARCH 31	**2017**		2016 restated (note 23)	
	Revenue	**% of Total**	Revenue	% of Total
BAE Systems	**$2,906**	**7.5**	$-	-
Boeing[1]	**13,779**	**35.7**	18,372	46.0
Bombardier	**4,916**	**12.7**	4,494	11.3
Lockheed Martin	**3,793**	**9.8**	1,905	4.8
Subaru Corporation (formerly Fuji Heavy Industries)	**5,227**	**13.6**	3,327	8.3
Other	**5,311**	**13.8**	5,774	14.5
Amortization and contract renegotiation of the unfavourable contract liability	**2,636**	**6.9**	6,069	15.1
Total	**38,568**	**100.0**	39,941	100.0

1. Includes Boeing program partner revenue

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

FOR THE QUARTER ENDED MARCH 31	**2017**		2016 restated (note 23)	
	Revenue	**% of Total**	Revenue	% of Total
Canada	**$6,635**	**17.2**	$5,579	14.0
USA	**20,527**	**53.2**	20,968	52.5
Europe	**3,113**	**8.1**	3,499	8.8
Asia	**5,567**	**14.5**	3,656	9.2
Australia	**75**	**0.2**	128	0.3
Other	**15**	**-**	42	0.1
Amortization and contract renegotiation of the unfavourable contract liability	**2,636**	**6.8**	6,069	15.1
Total	**38,568**	**100.0**	39,941	100.0

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

FOR THE QUARTER ENDED MARCH 31	**2017**		2016 restated (note 23)	
	Total Assets	**% of Total**	Total Assets	% of Total
Canada	**$60,496**	**48.0**	$61,664	46.4
USA	**65,451**	**52.0**	71,375	53.6
Total	**125,947**	**100.0**	133,039	100.0

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

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

FOR THE QUARTER ENDED MARCH 31, 2017	**Total**	**ASI**	**Comtek**	**ACF**	**Corporate**
Revenue	**$38,568**	$13,504	$4,464	$20,600	$-
Cost of sales	**41,460**	14,353	3,855	23,252	-
Gross (loss) profit	**(2,892)**	(849)	609	(2,652)	-
Selling, general, and admin expense	**5,655**	1,260	604	1,201	2,590
Depreciation and amortization	**70**	50	15	5	-
Operating (loss) gain	**(8,617)**	(2,159)	(10)	(3,858)	(2,590)

FOR THE QUARTER ENDED MARCH 31, 2016 restated (note 23)	**Total**	**ASI**	**Comtek**	**ACF**	**Corporate**
Revenue	**$39,941**	$10,686	$5,633	$23,622	$-
Cost of sales	**39,331**	10,944	3,904	24,483	-
Gross (loss) profit	**610**	(258)	1,729	(861)	-
Selling, general, and admin expense	**7,953**	1,794	729	3,273	2,157
Depreciation and amortization	**225**	83	13	129	-
Operating (loss) income	**(7,568)**	(2.135)	987	(4,263)	(2,157)

	March 31, 2017		December 31, 2016	
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$37,882**	**30.0**	$38,700	29.1
Comtek Advanced Structures Ltd.	**10,304**	**8.2**	10,632	8.0
Avcorp Composite Fabrication Inc.	**65,451**	**52.0**	71,375	53.6
Corporate	**12,310**	**9.8**	12,332	9.3
Total	**125,947**	**100.0**	133,039	100.0

	March 31, 2017		December 31, 2016	
	Total Liabilities	**% of Total**	Total Liabilities	% of Total
Avcorp Industries Inc.	**$21,943**	**15.4**	$21,308	15.2
Comtek Advanced Structures Ltd.	**5,371**	**3.8**	3,537	2.5
Avcorp Composite Fabrication Inc.	**87,860**	**61.8**	90,749	64.9
Corporate	**26,884**	**19.0**	24,328	17.4
Total	**142,058**	**100.0**	139,922	100.0

23. Business Acquisition

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

Through the Acquisition, Avcorp acquired the composite Aerostructures division of Hitco but did not acquire any assets of Hitco's materials division that is responsible for the production of specialty materials. The Acquisition included all of the assets, properties and rights held by Hitco related to the Business including:

- inventory, packaging materials, and consumables of the Business;
- fixed assets, equipment and tooling assets primarily used in the Business;
- accounts or notes receivable related to the Business;
- prepaid expenses and deposits primarily related to the Business;
- the intellectual property of the Business together with all of the goodwill associated with the intellectual property;
- the goodwill related to the Business, together with the exclusive right to hold Avcorp out as carrying on the Business in succession to Hitco;
- the right to use the name "Hitco Carbon Composites" or any variation thereof in connection with the Business; and
- several purchase contracts held by Hitco.

The final purchase price allocation for the acquisition reflects various fair value estimates and analysis, including the final work performed related to the fair values of certain tangible assets and liabilities acquired and the valuation of intangible assets acquired.

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

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

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

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

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

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

The finalization adjustments made to the preliminary purchase price allocation presented in the December 31, 2016 financial statements, reflected new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of the date. The measurement period adjustments which impact the quarter ended March 31, 2016 predominately relate to updating fair value estimates in the following areas:

- Intangible – lease: Management obtained more relevant market value information in order to determine the fair value estimate of the lease assumed in Gardena. The adjustments to these items resulted in reduced amortization in the quarter ended March 31, 2016.

- Intangible – customer contract re-compete and customer backlog: The fair value of these intangible assets were adjusted to reflect more accurate profitability assessments of the underlying contracts obtained subsequent to the acquisition. The adjustments to these items resulted in reduced amortization in the quarter ended March 31, 2016.
- Customer advance and unfavourable contracts liability: Management obtained additional information on the profitability of the related programs subsequent to the acquisition. This additional profitability information has been reflected in the updated fair value estimates of these items. The adjustments to these items resulted in additional amortization in the quarter ended March 31, 2016.

			March 31, 2016
	As Previously Reported	Adjustment	Restated
Revenues	$35,347	$4,594	$39,941
Cost of sales	38,383	948	39,331
Gross (loss) profit	(3,036)	3,646	610
Administrative and general expenses	9,138	(1,185)	7,953
Office equipment depreciation	225	-	225
Operating (loss) gain	(12,399)	4,831	(7,568)
Finance costs – net	12	-	12
Foreign exchange (gain)	(270)	-	(270)
Net (gain) on sale of equipment	(50)	-	(50)
(Loss) income before income tax	(12,091)	4,831	(7,260)
Income tax expense	-	-	-
Net (loss) income for the period	(12,091)	4,831	(7,260)
Other comprehensive loss	487	-	487
Net (loss) income and total comprehensive (loss) income for the period	(11,604)	5,945	(6,773)

24. Subsequent events

a) On April 4, 2017, Avcorp received the USD$9,220,000 remaining consideration receivable from the acquisition of the US-based composite Aerostructures division of Hitco Carbon Composites Inc. USD$6,511,000 of the consideration payment was utilized to repay a portion of the debt facility with a Canadian Chartered bank (note 12). A further amount of USD$907,000 was utilized to repay the Loan with Panta (note 17c).

b) On April 7, 2017, a term loan entered into with Panta become due and payable for the principal amount of USD$5,000,000 and USD$187,000 of accrued and unpaid interest (note 17b). As at that date the Company and Panta amended the term loan to provide for a maturity date which is the earlier of the date on which credit is available to be drawn by the Company under the Expanded Loan with a Canadian Chartered bank, and July 6, 2017, with interest continuing at 8% per year. The Company incurred a USD$100,000 amendment fee in this regard.

c) On May 26, 2017, the Company entered into a loan agreement to expand its loan facility with a Canadian Chartered bank ("the Expanded Loan"). This loan agreement amends, restates and replaces the loan agreement entered into on September 27, 2012 (note 12). The Expanded Loan provides an additional borrowing capacity of up to USD$35,000,000 increasing its existing, as at March 31, 2017, USD$23,000,000 revolving loan in total up to USD$58,000,000. The Expanded Loan matures on June 30, 2020.

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

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

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

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

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

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

The Expanded Loan 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.

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

Eric Kohn TD [1*]
DIRECTOR
Managing Partner
Barons Financial Services SA
Geneva, Switzerland

Kees de Koning [1][3]
DIRECTOR
Nootdorp, The Netherlands

Elizabeth Otis [2][3]
DIRECTOR
Palm Springs, California

Jaap Rosen Jacobson [2][3*]
DIRECTOR
President
Panta Holdings B.V.
Mijdrecht, The Netherlands

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

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

MANAGEMENT

Ken McQueen
Avcorp Group Vice President, Human Resources
New Westminster, British Columbia

Jim Renaud
Avcorp Group Senior Vice President, Customers
Huntington Beach, California

Brent Collver
President
Comtek Advanced Structures Ltd.
Oakville, Ontario

Marty Jones
General Manager
Avcorp Composite Fabrication Inc.
Redondo Beach, California

Amandeep Kaler
General Manager
Avcorp Structures & Integration
Surrey, British Columbia

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

* Designates the Committee Chair

DIRECTORY

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

Deloitte LLP
Chartered Professional Accountants
Vancouver, British Columbia

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Toronto Stock Exchange
Symbol AVP

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