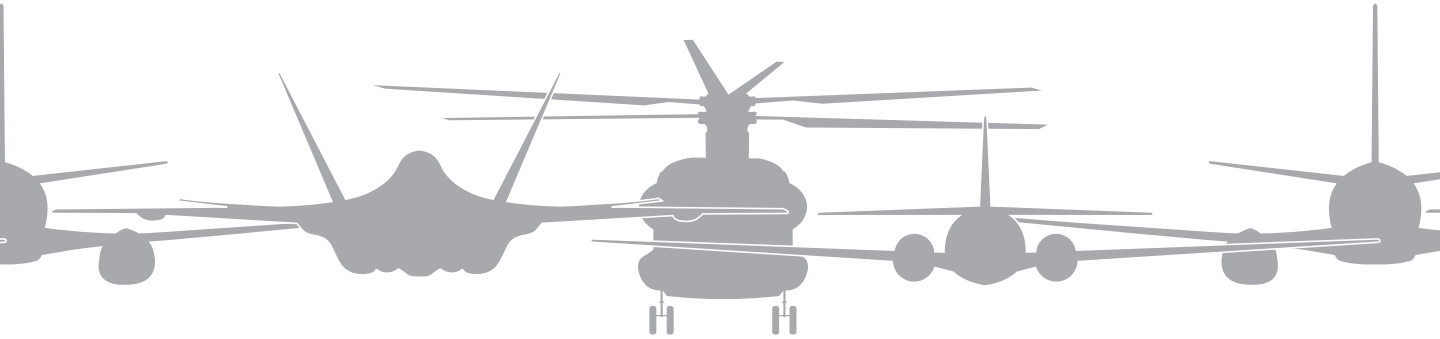
Avcorp Industries Inc.



2008
Q3 Report

ABOUT AVCORP INDUSTRIES INC. **Avcorp designs and builds major airframe structures for some of the world's leading aircraft companies, including Boeing, Bombardier, and Cessna. With more than 50 years of experience, 750 skilled employees and 385,000 square feet of facilities, Avcorp offers integrated composite and metallic aircraft structures to aircraft manufacturers, a distinct advantage in the pursuit of contracts for new aircraft designs, which require lower-cost, light weight, strong, reliable structures. Avcorp is a Canadian public company traded on the Toronto Stock Exchange (TSX:AVP).**

Management Discussion & Analysis

This Management Discussion and Analysis has been prepared as of November 3, 2008, and should be read in conjunction with the Company's unaudited interim financial statements and notes thereto for the three and nine month periods ended September 30, 2008, and with the audited financial statements and notes thereto for the year ended December 31, 2007.

Description of Business

Avcorp Industries Inc. (the Company) is an important supplier of subcontract design, fabrication and assembly services to major aircraft manufacturers. Management is dedicated to creating positive economic value added for shareholders while satisfying all other stakeholders. We are doing so by improving productivity, enhancing organizational capabilities and ensuring that growth opportunities have a positive impact on the bottom line.

Financial Overview

QUARTERLY RESULTS

The following table provides selected quarterly financial information for the eight most recent fiscal quarters to September 30, 2008.

QUARTERLY RESULTS

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

FOR THE THREE MONTHS ENDED	**2008**			2007				2006
	SEP 30	JUN 30	MAR 31	DEC 31	SEP 30	JUN 30	MAR 31	DEC 31
Revenue	**$ 30,894**	$ 32,389	$ 31,151	$ 26,878	$ 26,696	$ 29,352	$ 27,357	$ 25,944
Income (loss) from operations	**1,004**	859	183	(1,857)	628	859	575	740
EBITDA[1,2]	**1,676**[3]	2,218	1,375	(1,282)	1,493	2,304	1,629	1,642
Net income (loss)	**(220)**[3]	364	(423)	(2,943)	32	817	375	365
EBITDA per share[1,2]								
Basic	**0.05**[3]	0.07	0.04	(0.04)	0.05	0.08	0.06	0.06
Diluted	**0.05**[3]	0.07	0.04	(0.04)	0.04	0.07	0.05	0.05
Net income (loss) per share								
Basic	**(0.01)**[3]	0.01	(0.01)	(0.10)	0.00	0.03	0.01	0.01
Diluted	**(0.01)**[3]	0.01	(0.01)	(0.10)	0.00	0.02	0.01	0.01
Long-term debt	**7,192**	7,424	6,306	6,761	6,419	5,064	5,041	4,957

1 EBITDA = earnings before interest, taxes, depreciation and amortization
2 EBITDA is not a recognized term under GAAP
3 Inclusive of $759,000 write-down of investment (note 7 to the financial statements)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007 RESULTS OVERVIEW

During the quarter ended September 30, 2008, the Company recorded earnings from operations of $1,004,000 on $30,894,000 revenue, a 60% improvement over the $628,000 earnings from operations from $26,696,000 revenue for the same quarter of the preceding year and a net loss for the current quarter of $220,000 as a result of a $759,000 non-cash write-down (September 30, 2007: $32,000 net income).

As at September 30, 2008, management estimated that there has been a decline in value of the Company's investment in Eclipse Aviation Corporation. Accordingly, the investment has been written down to $Nil (note 7 to the financial statements). This non-cash write-down had the impact of reducing net income by $759,000.

During the third quarter of 2008, the Company reduced its previously recorded provision for loss making contracts, thereby increasing net income by $332,000 (September 30, 2007: $229,000 decrease to net income). Income from unrealized derivative gains amounted to $Nil for the quarter ended September 30, 2008 as compared to a gain of $6,000 for the same quarter in the preceding year. Foreign exchange gains for the current quarter totalled $26,000 (September 30, 2007: $298,000 gain).

On a year-to-date basis, the Company recorded a net loss of $279,000 on $94,434,000 revenue as compared to $1,224,000 net income from $83,405,000 revenue for the same period in 2007. The primary causes for the reduction of net income is the aggregate of the $759,000 write-down in investment during 2008 and the unrealized derivative gains amounting to $697,000 in 2007.

Cash flows from operating activities provided $2,506,000 of cash, as compared to $1,429,000 during the same quarter last year. During the first three quarters of 2008 and 2007, the Company generated cash flows from operating activities in the amounts of $2,506,000 and $3,693,000 respectively. The Company has a working capital surplus of $4,460,000 as at September 30, 2008 (December 31, 2007: $4,417,000) and an accumulated deficit of $53,756,000 at September 30, 2008 (December 31, 2007: $53,204,000).

At September 30, 2008, the Company had utilized $10,379,000 of its $17,000,000 operating line of credit (December 31, 2007: $11,279,000).

Holders of warrants exercised a total of 675,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 244,660 common shares at a price of $0.90, for gross proceeds of $221,000. The remaining 430,340 common shares issued at a price of $0.90 amounting to $387,000 were used to pay amounts owing.

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

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

As at September 30, 2008, the Company was in compliance with all of its financial covenants associated with its debt.

Management has made an assessment as at the balance sheet date of the Company's ability to continue as a going concern. In making this assessment, management has taken into account all available information relating to the future 12-month period.

Management believes that the financing activities undertaken to date, and the ongoing efforts to reduce costs and improve productivity and working capital usage, make the use of the going concern basis appropriate; however, there can be no assurance that the Company will be successful with all initiatives.

While these financial statements have been prepared using Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, in the event that the Company is unable to obtain additional financing if required, and without the continued support of significant shareholders (note 18 to the financial statements), there is significant doubt about the Company's ability to continue as a going concern as a consequence of the adverse conditions and events described above.

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

Revenue

Revenue for the quarter ended September 30, 2008 was $30,894,000 (September 30, 2007: $26,696,000). Revenues from the Company's customers are as follows.

REVENUE DISTRIBUTION

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

	THREE MONTHS ENDED SEPTEMBER 30				NINE MONTHS ENDED SEPTEMBER 30			
	2008		2007		**2008**		2007	
	REVENUE	**% OF TOTAL**	REVENUE	% OF TOTAL	**REVENUE**	**% OF TOTAL**	REVENUE	% OF TOTAL
Boeing	**$ 5,295**	**17.1**	$ 5,187	19.4	**$ 16,113**	**17.1**	$ 15,100	18.1
Bombardier	**6,304**	**20.4**	5,993	22.4	**20,667**	**21.9**	17,652	21.2
Cessna	**16,088**	**52.1**	13,037	48.8	**45,711**	**48.4**	43,510	52.2
Other	**3,207**	**10.4**	2,479	9.4	**11,943**	**12.6**	7,143	8.5
Total	**30,894**	**100.0**	26,696	100.0	**94,434**	**100.0**	83,405	100.0

Most of the Company's growth in revenue during the current quarter, relative to 2007, was from the consolidation of the operations of Comtek Advanced Structures Ltd (Comtek). Boeing Commercial Airplane Group (Boeing), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna) continued to be the Company's three major customers.

New statements of work with Boeing as well as a 12% increase in the shipments of larger assemblies for the 737 aircraft are the primary cause for the increase in sales to this customer over those for the same period last year. The primary source of revenue from Boeing is from the 737 aircraft. The Company continues to work towards obtaining additional new contracts supporting 737, 747, 767, 777 and 787 commercial jet programs. Work stoppages at Boeing have not to date affected revenue for 2008. The work stoppage at Boeing has ended as at the date of this report. The impact on future revenues has not been determined at this time.

Deliveries to Bombardier increased for all programs during the current quarter relative to the quarter ended September 30, 2007, with the exception of the CRJ700 regional jet program. Bombardier's termination for convenience of the CRJ700 regional jet program caused a $2,448,000 reduction in revenues from the same quarter in 2007. The Company's primary source of revenues from Bombardier in 2008 will continue to be from components on the CL605 and CL850 business jets.

Deliveries of major structures to Cessna increased by 23% in the third quarter of 2008, relative to 2007. The primary sources of revenue from Cessna are from deliveries of components for the Citation Sovereign business jet and the Citation CJ3 business jet. A continuation of the current production rates for components of these aircraft is expected for the remainder of 2008.

Sales from other customers continued to grow during the third quarter 2008, as compared to the quarter ended September 30, 2007, primarily as a result of consolidation of Comtek operations.

Gross Profit

Gross profit (revenue less cost of sales) for the quarter ended September 30, 2008 was 17.6% of revenue as compared to 13.3% of revenue for the quarter ended September 30, 2007. This represents the highest gross profit percentage in over two years; continuing the quarter-on-quarter improvement.

Continued operational performance improvements in assembly and fabrication lines have been slightly diminished as the Company experienced high levels of workforce overtime during most of the current quarter, due to late deliveries of detailed parts from external and internal supply chains. Management has reduced workforce overtime during the latter stages of the third quarter 2008.

The operational performance improvements have allowed the Company to reverse $332,000 of its provision for expected future losses on certain programs. There remains recorded a $386,000 provision for loss-making programs as at September 30, 2008.

Administration and General Expenses
As a percentage of revenue, administration and general expenses increased from 9.3% for the quarter ended September 30, 2007 to 10.7% for this quarter. Administrative and general expenses have increased for the quarter ended September 30, 2008 relative to last year, primarily due to continued staffing increases in the Company's business support departments in preparation for new program development, and the acquisition of Comtek.

Foreign Exchange Gain
The Company recorded a $26,000 foreign exchange gain during the third quarter of 2008 (September 30, 2007: $298,000 gain) as a result of holding foreign-currency-denominated receivables, payables and debt.

Other Income
The Company uses derivative financial instruments to reduce its exposure to foreign currency and price risk associated with its revenues and costs of certain procured items. No gain or loss arose during the quarter ended September 30, 2008, as a result of holding purchase and sales contracts having embedded derivatives, while a loss of $6,000 during the third quarter of 2007 arose primarily as a result of derivative financial instruments associated with its sales and procurement contracts. The Company does not have any unrealized foreign-exchange-forward contracts as at September 30, 2008 and consequently no such gain or loss has been recorded.

All other financial instruments have been recorded at cost or amortized cost, subject to impairment reviews, such as the investment in Eclipse Aviation Corporation (note 7 to the financial statements).

Earnings Before Interest, Taxes, Depreciation & Amortization
Earnings before interest, taxes, depreciation and amortization (EBITDA) were $1,971,000 for the quarter ended September 30, 2008 compared to $1,493,000 for the quarter ended September 30, 2007.

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

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Income (loss) for the period	**$ (220)**	$ 32	**$ (279)**	$ 1,224
Interest expense and financing charges	**465**	602	**1,564**	1,535
Income tax expense	**—**	—	**—**	—
Depreciation	**1,065**	757	**3,054**	2,302
Amortization	**366**	102	**930**	365
	1,676	1,493	**5,269**	5,426

EBITDA is a term that does not have a standardized meaning under Canadian generally accepted accounting principles (GAAP). EBITDA has not been adjusted for the $759,000 write-down of investment (note 7 to the financial statements).

Interest and Financing Charges
Total interest and financing charges on both short- and long-term debt, some to related parties, for the quarter ended September 30, 2008 was $465,000 as compared to $602,000 for the same quarter in the previous year. This is a result of periodic lower utilization of the operating line of credit, reduced debenture principal and a reduction of royalty payment resulting from Bombardier's termination of the CRJ700 regional jet contract with the Company.

Write-Down of Investment
As at September 30, 2008, management estimated that there has been a decline in value of the Company's investment in Eclipse Aviation Corporation. Accordingly, the investment has been written down to $Nil (note 7 to the financial statements). This non-cash write-down had the impact of reducing net income by $759,000.

Income Taxes
The Company has not incurred a tax expense during the current year (September 30, 2007: $Nil).

Income

The loss for the quarter ended September 30, 2008 was $220,000 compared to net income of $32,000 for the quarter ended September 30, 2007. Operational performance has strengthened during the current quarter over the same quarter in the prior year, as is reflected in the improved gross profit and income from operations; however, current quarter income was adversely affected by the $759,000 non-cash write-down of the Company's investment (note 7 to the financial statements).

Liquidity and Capital Resources

The Company ended the quarter with bank operating line utilization of $10,379,000 compared to $11,279,000 as at December 31, 2007.

Cash Flows from Operating Activities

Cash provided from operating activities, before consideration of changes in non-cash items relating to operating activities, was $2,506,000 for the quarter ended September 30, 2008 compared to cash provided of $1,429,000 for the same quarter last year.

Non-cash operating assets and liabilities provided $341,000 cash during the current quarter, compared to a utilization of $3,854,000 for the same quarter last year. The 2007 utilization was primarily as a result of reducing operating liabilities; a similar movement in liabilities did not occur in 2008.

Cash Flows from Investing Activities

During the quarter, the Company purchased capital assets totalling $443,000 as compared to $681,000 during the quarter ended September 30, 2007. The purchases consisted of manufacturing equipment, to augment capacity, capability, and increase operating efficiencies, and a continued upgrading of the information technology infrastructure.

Additionally, the Company invested $855,000 (September 30, 2007: $210,000) in tooling and in improving the production efficiencies of various program lines. A significant portion of this investment was specifically invested in new product introduction for the Cessna Citation CJ4 business jet program, for which the Company will commence delivering tail assemblies in 2009.

Cash Flows from Financing Activities

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

During the quarter, the Company repaid $624,000 of current and long-term debt consisting of $322,000 in equipment financing, $86,000 in royalty payments, $40,000 in term loan repayments, and $176,000 in debenture repayments.

Dividends paid on the preferred shares issued on July 10, 2006 amounted to $190,000 for the quarter ended September 30, 2008.

On September 30, 2008, the ratio of the Company's current assets to current liabilities was 1.16:1, which is the same as at December 31, 2007.

Contractual Obligations

PAYMENTS DUE BY PERIOD

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

	TOTAL	2008	2009 – 2011	2012 – 2013	POST 2013
Convertible debentures	**$ 4,197**	$ 100	$ 4,097	$ —	$ —
Capital lease obligation	**3,898**	257	2,744	897	—
Term loan	**264**	23	241	—	—
Purchase obligation[1, 2]	**25,109**	151	7,741	4,933	12,284
Other long-term obligations[3]	**777**	—	777	—	—
Total contractual obligations	**34,245**	531	15,600	5,830	12,284

1 Purchase obligations include payments for the Company's operating and property leases.
2 During 2003, the Company entered into a 15-year leaseback agreement with the purchaser of its property. As part of the consideration from the sale of the property, the Company received a $1,500,000 rent credit to be applied to rent in 2008 and 2009.
3 Fees payable as consideration for a performance guarantee have been excluded, as their continuance is subject to annual review (note 18 to the financial statements). This amount represents obligations the Company has with Technology Partnerships Canada.

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

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

Capital Stock

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and third preferred shares, issueable in series, the terms of which will be determined by the Company's directors at the time of creation of each series. There were 32,314,929 common shares issued and 300,881 reserved at September 30, 2008. The book value of common shares issued and outstanding as at September 30, 2008 was $64,915,000.

As at November 3, 2008, there were 32,314,929 common shares, 816,800 preference shares, 1,527,880 warrants and 573,000 options issued and outstanding.

Recent Accounting Pronouncements

The unaudited interim consolidated financial statements for the quarter ended September 30, 2008, have been prepared using accounting policies consistent with the audited financial statements for the year ended December 31, 2007 except for the following.

Effective January 1, 2008, the Company adopted new Canadian Institute of Chartered Accountants (CICA) standards 1535, 3031, 3862 and 3863 and will adopt effective January 1, 2009, standard 3064.

- Section 1535 – Capital Disclosures: This section requires the Company to disclose its objectives, policies and processes for managing capital.
- Section 3031 – Inventories: This section prescribes the accounting treatment for inventories and provides guidance on the determination of cost and subsequent recognition as an expense, including any write down to net realizable value.
- Section 3862 – Financial Instruments: This section enhances the disclosure requirements on the nature and extent of risks arising from financial instruments and how the Company manages those risks.
- Section 3863 – Financial Instruments Presentation: This section provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instrument related presentation disclosures.
- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred.

Comparative Figures

Certain prior period figures have been reclassified to conform with current period presentation.

International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for publicly accountable profit-orientated enterprises for interim and annual financial statements effective January 1, 2011. The Company is presently considering the effect these standards will have on its financial statements.

Operations Overview

DELIVERY AND QUALITY PERFORMANCE

Deliveries as at September 30, 2008 were at planned levels for Cessna, Bombardier and Boeing programs with the following exceptions.

Quality and schedule problems from two specific suppliers have caused deliveries on a Cessna program to fall behind plan. The Company is actively involved with the suppliers in correcting this issue.

Inconsistent deliveries of primer paints from a sole-source, customer-stipulated supplier have caused the Company to ship late on certain Boeing programs. An effort is being made by the Company to increase safety stocks of these purchased products in order to reduce the risk of future shortages.

All other program deliveries were on schedule or not impacting customer requirements.

Quality problems incurred prior to 2008 from a specific supplier have caused a requirement for an inspection and possible rework for all delivered components to a non-original equipment manufacturer customer. Provisions in the amount of $1,454,000 for management's estimate of the costs of inspection and rework along with a possible equivalent claim against the supplier were recorded during 2007 and remain in the accompanying financial statements. As at September 30, 2008, the status of this provision has remained unchanged.

ORDER BACKLOG

The Company operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's contracts with Boeing extend from January 2007 to December 2011. The Bombardier and Cessna agreements extend for the life of the programs.

The Company defines order backlog as the value of purchase orders it expects to receive from these contracts based on manufacturers' projections and current degrees of exclusivity. The order backlog as at September 30, 2008 was $568 million, compared to $557 million as at June 30, 2008. The changes in order backlog are as follows:

- $42 million increase in order backlog primarily due to production rate increases and extended production lives of various existing programs; and
- $31 million decrease in order backlog resulting from revenues recorded during the quarter ended September 30, 2008.

Order backlog size is affected by changes in foreign exchange rates. Please refer to comments on currency risk.

SUPPLY CHAIN

Vendor quality performance met targeted levels during the quarter, with the exception of a limited number of vendors which the Company is managing on a day-to-day basis and in some cases with on-site personnel. A material discrepancy was identified during the third quarter 2008. The vendor and customer were appropriately notified, with the vendor assuming responsibility for remediation.

In addition to the previously-noted primer paint supplier, 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 are underway which will be fully implemented during the second half of 2008. Hardware pricing continues to place pressure on 2008 cost levels, due to general industry shortages and high demand. The securing of additional long-term contracts with key suppliers continues.

WORKING CAPITAL UTILIZATION

As at September 30, 2008 working capital, defined as cash plus accounts receivable and inventories less current bank financing and accounts payable, has remained constant with December 31, 2007 (September 30, 2008: $3,903,000; December 31, 2007: $3,934,000). It should be noted that this is a non-GAAP measure. Total current assets less total current liabilities was in a surplus position of $4,417,000 at December 31, 2007 and a surplus of $4,460,000 at September 30, 2008. The Company's working capital balance during 2008 has remained relatively unchanged from December 31, 2007.

FINANCIAL RESOURCES

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

NON-FINANCIAL RESOURCES

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

Human Resources

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

The number of employees at September 30, 2008 was 785 (September 30, 2007: 671). The primary cause for the increase in the number of employees relative to last year is attributable to the acquisition of Comtek. 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

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

Technology upgrades in high-speed machining are continuing into 2008. Non-destructive (ultrasonic) testing equipment has been purchased and is fully operational. This investment has allowed the Company to further augment its quality assurance systems and bring currently out-sourced work in-house, thereby reducing costs and satisfy customer requirements.

Given the capacity constraints in the supply chain market for machined parts during 2007 and into 2008, the Company will also be investing in additional capacity where it has been demonstrated that there is a chronic shortage of reliable supply. Bringing additional currently-outsourced work in-house will help lower costs by reducing shortages and capturing margin currently in supplier prices.

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

RISK ASSESSMENT

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

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

The Company's view is that, with its financial structure, acquisition of a composite manufacturer and strategic plan in place, the Company is in a position to face and mitigate these risks.

Procured Materials and Parts

The Company is continuing its efforts to utilize its customer relationships to reduce or minimize the increase in cost of bought-in materials and parts as well as ensure delivery commitments. Delivery delays on raw materials, in particular aluminum plate and machined components, have been partially mitigated by continued efforts with dual sourcing. The Company has increased safety stocks of primer paint in order to mitigate the risk of inconsistent deliveries.

Aircraft Production Rates

The following industry and program trends impact the Company.

- Industry research indicates that the aerostructures market for commercial aircraft, business jets, as well as defence aircraft, will continue to grow through 2010.
- Boeing is increasing the rates on the 737 and 777 programs, while giving the 747 program renewed life with the introduction of the 747-8. Near-term deliveries for all Boeing programs will be reduced as a result of a work stoppage at Boeing.

- The production rate on the Boeing 757-200 wing adapter plug for winglet retrofits increased through 2006, almost tripled in 2007 and has continued at slightly lower levels through the first half of 2008; the second half of 2008 will see lower deliveries for this product.
- Bombardier Challenger 850 and the Challenger 605 business jet aircraft production rates have increased in 2008 and are forecasted to continue to increase into 2009.
- Cessna Citation Sovereign and CJ3 business jet rates have increased significantly through 2007, with continued solid demand and increased order backlogs into 2008 to 2012.

Competitors

The long-term trend is to more intense competition from larger entities in Asia and Europe, while original equipment manufacturers (OEM) continue to increase the size and amount of outsourced components. The Company continues to examine opportunities for mergers or acquisitions, on a global basis, that would improve competitiveness and acquire vertical strengths or additional strategic capabilities.

Cost Reductions

Approximately 52% of the Company's cost of sales is related to labour and overhead and 48% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its Western European and US competitors and higher than those in Asia, Eastern Europe and Mexico. The Company has achieved an element of labour cost certainty via a four-year collective agreement with its labour force expiring in September 2009.

The Company continues to focus on cost reductions for direct labour, material and overhead. These reductions will be achieved through a reduction of internal and external supply chain parts shortages, continued negotiation of long-term agreements for 50% of key suppliers, increased plant capacity augmented by technological improvements, and continued focus on cost targets at all levels of the organization.

Composite Materials

The December 31, 2007 acquisition of Comtek adds ongoing operations expertise in the design and competitive manufacture of advanced composite aerostructures and mitigates the Company's risk from the trend to greater use of composite material in primary structures in each new generation of aircraft.

Outlook

Additions to the Company's backlog, amounting to $42 million during the quarter ended September 30, 2008, were primarily as a result of extended production lives of various existing OEM customers programs, and the acquisition of Comtek. Cessna continues to be the Company's largest customer. Overall, revenue in 2008 is expected to remain constant in comparison to 2007 for existing operations, while the most significant growth of revenue in 2008 will be derived from the Company's December 31, 2007 acquisition of Comtek.

Transactions with Related Parties

During the year ended December 31, 2005, the Company entered into an agreement with a certain shareholder in consideration of mutual agreements with a Canadian chartered bank under which the shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a 5% fee on the $2,000,000 limited guarantee calculated on a daily basis. Fees paid to a certain shareholder during the quarter ended September 30, 2008 amounted to $Nil (September 30, 2007: $Nil). Fees payable to a certain shareholder as at September 30, 2008 are $50,000 (September 30, 2007: $50,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $25,000 for the quarter ended September 30, 2008 (September 30, 2007: $25,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to certain shareholders during the quarter ended September 30, 2008 amounted to $Nil (September 30, 2007: $Nil). Fees payable to certain shareholders as at September 30, 2008 are $120,000 (September 30, 2007: $120,000). These fees are included in the Statements of Operations as cost of sales and amount to $60,000 for the quarter ended September 30, 2008 (September 30, 2007: $60,000).

Other related-party transactions are disclosed elsewhere in these financial statements (note 11b to the financial statements).

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

Proposed Transactions

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

Critical Accounting Estimates

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

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

- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues.
- Unamortized development and tooling costs, net of related government assistance, which reflect the Company's investment in new programs and manufacturing process development, are recorded at $3,025,000 (December 31, 2007: $1,545,000). These costs are to be amortized over the number of units which management believes is a conservative estimate of deliveries for the programs to the customer. Development costs will be written off proportionately to any anticipated reduction in expected unit deliveries to the customer. No such reduction in deliveries exists at this time. Furthermore, the Company will write off any amounts of development costs, which it estimates will not be recoverable from the recurring programs to which they relate. At this time, management estimates that all development costs are recoverable.
- An estimation is made of the useful life of equipment. Useful life is measured in terms of years or on a units of production basis.

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

- An estimation is made of the useful life of intangible assets. Useful life is measured as a range between one and ten years.
- An estimation is made of the cost of the Company's stock-based compensation and other stock-based payments made in exchange for goods and services. The Company has adopted the Black-Scholes model for its fair value base method of accounting for stock options (note 13 to the financial statements). Option-pricing models require the input of highly subjective assumptions regarding the expected volatility. Changes in assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options at the date of grant.
- On June 17, 2002, the Company acquired 5,264 Series D Preferred Stock of Eclipse Aviation Corporation for $1,527,000. On December 31, 2004, the Company wrote down its investment by $768,000 to its then estimated fair value of $759,000. On September 30, 2008, the Company wrote down its investment by a further $759,000 to an estimated fair value of $Nil.
- During the fourth quarter 2007, the Company became aware of a requirement to rework previously delivered product. As at the date of this report, it is uncertain as to when the rectification will take place. In consideration of the nature of rework required, and the possible extent to which the defect affects delivered product, the Company has accrued a $1,454,000 charge within cost of sales. In the opinion of the Company, an equivalent claim against the manufacturer of a sub-component to the product can be made. Accordingly, a $1,454,000 recovery has been accrued within cost of sales. The amounts recorded are based on management's best estimate of the amount of product affected and the timing of the rework, which is expected to occur over a four to five year period.

Financial Instruments and Other Instruments

INTEREST RATE RISK

The Company is exposed to interest rate risk by its operating line of credit at a rate of bank prime plus 0.75%. As at September 30, 2008, the Company is exposed to interest rate risk on the utilized portion of its $17,000,000 operating line of credit at rates of bank prime plus 0.375%, 0.50%, 0.675% or 0.75% determined on a quarterly basis according to specified measures of the ratio of debt to tangible net worth. The Company lowers interest rate costs by managing utilization of the operating line of credit to the lowest amount practical.

All of the Company's other financial instruments are at fixed rates.

CURRENCY RISK

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced.

The amount of foreign exchange gain recorded in the third quarter was $26,000 (September 30, 2007: $298,000 gain). The Company used derivative financial instruments to mitigate its exposure to currency risks in 2007 and into the first quarter 2008 (note 5 to the financial statements). No such instruments were in place as at September 30, 2008.

Other Items

DISCLOSURE CONTROLS AND PROCEDURES, AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

The Chief Executive Officer and the Vice President, Finance, have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of September 30, 2008 and concluded that the Company's current disclosure controls and procedures 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 third quarter ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

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

Report of Management

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

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

Edward M. Merlo
VICE PRESIDENT, FINANCE
AND CORPORATE SECRETARY

Mark Van Rooij
CHIEF EXECUTIVE OFFICER

Notice of No Auditor Review of Interim Financial Statements

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Consolidated Balance Sheets

As at September 30, 2008 and December 31, 2007
(unaudited, in thousands of Canadian dollars)

	SEPTEMBER 30, 2008	DECEMBER 31, 2007
Assets		
CURRENT ASSETS		
Accounts receivable	**$ 11,878**	$ 12,224
Inventories (note 6)	**17,401**	17,801
Prepayments	**2,501**	2,401
Other assets (note 5)	**—**	138
	31,780	32,564
Prepaid rent	**—**	481
Development costs	**3,025**	1,545
Property, plant and equipment	**20,429**	20,310
Investment (note 7)	**—**	759
Warranty claim receivable (note 17)	**1,454**	1,454
Intangible assets (note 8)	**2,269**	2,620
Goodwill (note 9)	**571**	571
	59,528	60,304
Liabilities		
CURRENT LIABILITIES		
Bank indebtedness	**10,379**	11,279
Accounts payable and accrued liabilities	**14,997**	14,812
Current portion of long-term debt (note 10)	**1,944**	2,056
	27,320	28,147
Deferred gain	**465**	501
Lease inducement	**986**	1,060
Deferred tooling revenues	**2,439**	2,676
Long-term debt (note 10)	**7,192**	6,761
Warranty provision (note 17)	**1,454**	1,454
Future income tax liability	**1,186**	1,186
	41,042	41,785
Shareholders' Equity		
Capital stock (note 11)	**62,269**	61,194
Preferred shares (note 12)	**7,622**	7,672
Contributed surplus	**2,646**	2,857
Deficit	**(54,051)**	(53,204)
	18,486	18,519
	59,528	60,304

Nature of operations and going concern (note 1)
Contingencies (note 17)
Subsequent event (note 20)

Approved by the Board of Directors

Michael C. Scholz
CHAIRMAN

Earnest Beaudin
COMMITTEE CHAIR,
AUDIT & CORPORATE GOVERNANCE COMMITTEE

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the three and nine months ended September 30, 2008 and September 30, 2007
(unaudited, in thousands of Canadian dollars, except number of shares and per share amounts)

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Revenues	**$ 30,894**	$ 26,696	**$ 94,434**	$ 83,405
Cost of sales and expenses				
Cost of sales	**25,443**	23,137	**79,798**	72,907
Administrative and general expenses	**3,291**	2,472	**9,791**	6,732
Depreciation	**1,182**	757	**3,405**	2,302
Foreign exchange gain	**(26)**	(298)	**(606)**	(598)
	29,890	26,068	**92,388**	81,343
Income from operations	**1,004**	628	**2,046**	2,062
Interest expense and financing charges (note 15)	**(465)**	(602)	**(1,564)**	(1,535)
Unrealized derivative gain (loss) (note 5)	**—**	6	**(2)**	697
Write-down of investment (note 7)	**(759)**	—	**(759)**	—
Income (loss) before income taxes	**(220)**	32	**(279)**	1,224
Income taxes	**—**	—	**—**	—
Income (loss) and comprehensive income (loss) for the period	**(220)**	32	**(279)**	1,224
Basic earnings (loss) per common share	**(0.01)**	0.00	**(0.01)**	0.04
Basic weighted average number of shares outstanding (000's)	**32,312**	30,870	**32,085**	29,111
Diluted earnings (loss) per common share	**(0.01)**	0.00	**(0.01)**	0.04
Diluted weighted average number of shares outstanding (000's)	**32,312**	36,816	**32,248**	34,248

Consolidated Statements of Deficit

For the three and nine months ended September 30, 2008 and September 30, 2007
(unaudited, in thousands of Canadian dollars)

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Deficit – Beginning of period	**$ (53,641)**	$ (49,898)	**$ (53,204)**	$ (50,565)
Income (loss) for the period	**(220)**	32	**(279)**	1,224
Preferred share dividends (note 12)	**(190)**	(199)	**(568)**	(724)
Deficit – End of period	**(54,051)**	(50,065)	**(54,051)**	(50,065)

Consolidated Statements of Cash Flows

For the three and nine months ended September 30, 2008 and September 30, 2007
(unaudited, in thousands of Canadian dollars)

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Cash flows from operating activities				
Income (loss) for the period	**$ (220)**	$ 32	**$ (279)**	$ 1,224
Items not affecting cash (note 16a)	**2,726**	1,397	**5,104**	2,469
	2,506	1,429	**4,825**	3,693
Change in non-cash items related to operating activities (note 16b)	**341**	(3,854)	**1,937**	(5,497)
	2,847	(2,425)	**6,762**	(1,804)
Cash flows from investing activities				
Purchase of property, plant and equipment	**(443)**	(681)	**(2,769)**	(3,483)
Payments relating to development costs and tooling	**(855)**	(210)	**(2,061)**	(747)
Advance on convertible loan receivable	**—**	(457)	**—**	(1,261)
Proceeds from sale of property, plant and equipment	**—**	—	**—**	15
	(1,298)	(1,348)	**(4,830)**	(5,476)
Cash flows from financing activities				
Net proceeds from bank indebtedness	**(735)**	965	**(900)**	5,383
Proceeds from current and long-term debt	**—**	1,903	**131**	2,761
Proceeds from sale and leaseback of property, plant and equipment	**—**	—	**1,215**	—
Proceeds from sale of tooling	**—**	—	**372**	—
Repayment of current and long-term debt	**(624)**	(685)	**(2,553)**	(2,164)
Issue of common shares (note 11)	**—**	1,848	**371**	2,091
Preferred share dividends (note 12)	**(190)**	(199)	**(568)**	(724)
Share issue expense	**—**	(59)	**—**	(67)
	(1,549)	3,773	**(1,932)**	7,280
NET CHANGE IN CASH AND CASH EQUIVALENTS	**—**	—	**—**	—
CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD	**—**	—	**—**	—
CASH AND CASH EQUIVALENTS – END OF PERIOD	**—**	—	**—**	—
INTEREST PAID	**388**	410	**1,114**	957

01 Nature of Operations and Going Concern

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

For the quarter ended September 30, 2008, the Company recorded a net loss of $220,000 (September 30, 2007: $32,000, net income). On a year-to-date basis, the Company recorded a net loss of $279,000 on $94,397,000 revenue, as compared to $1,224,000 net income from $83,405,000 revenue for the same period in 2007. The Company has a working capital surplus of $4,460,000 as at September 30, 2008 (December 31, 2007: $4,417,000) and an accumulated deficit of $54,051,000 at September 30, 2008 (December 31, 2007: $53,204,000).

As at September 30, 2008, the Company was in compliance with all of its financial covenants associated with its debt.

Management has made an assessment as at the balance sheet date of the Company's ability to continue as a going concern. In making this assessment, management has taken into account all available information relating to the future 12-month period.

Management believes that the financing activities undertaken to date, and the ongoing efforts to reduce costs and improve productivity and working capital usage, make the use of the going concern basis appropriate; however, there can be no assurance that the Company will be successful with all initiatives.

While these financial statements have been prepared using Canadian generally accepted accounting principles (GAAP) applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, in the event that the Company is unable to obtain additional financing if required, and without the continued support of significant shareholders (note 18), there is significant doubt about the Company's ability to continue as a going concern as a consequence of the adverse conditions and events described above.

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

02 Significant Accounting Policies

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

Certain information and note disclosures normally included in the annual consolidated financial statements prepared in accordance with Canadian GAAP have been condensed or excluded.

As a result, these unaudited interim consolidated financial statements do not contain all disclosures required to be included in the annual consolidated financial statements and should be read in conjunction with the most recent audited annual consolidated financial statements and notes thereto for the year ended December 31, 2007.

These unaudited interim consolidated financial statements are prepared following accounting policies consistent with the Company's audited annual consolidated financial statements and notes thereto for the year ended December 31, 2007, except for the following changes in accounting policies. Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants (CICA) standards 1535, 3031, 3962 and 3863.

- Section 1535 – Capital Disclosures: This section requires the Company to disclose its objectives, policies and processes for managing capital (note 3).
- Section 3031 – Inventories: This section prescribes the accounting treatment for inventories and provides guidance on the determination of cost and subsequent recognition as an expense, including any write-down to net realizable value (note 6).
- Section 3862 – Financial Instruments Disclosures: This section enhances the disclosure requirements on the nature and extent of risks arising from financial instruments and how the Company manages those risks (note 4).
- Section 3863 – Financial Instruments Presentation: This section provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instrument related presentation disclosures.

New accounting pronouncements not yet adopted. Effective January 1, 2009, the Company will adopt CICA standard 3064. The Company is considering the effect this standard may have on its financial statements.

- Section 3064 – Goodwill and Intangible Assets: This section replaces CICA 3062, "Goodwill and Intangible Assets", and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production and start-up costs and requires that these costs be expensed as incurred.

Certain prior period figures have been reclassified to conform with current period presentation.

Convergence with International Financial Reporting Standards

- In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted accounting principles (Canadian "GAAP"), as used by public companies, being evolved and converged with International Financial Reporting Standards ("IFRS") over a transitional period which will be complete by 2011. As the International Accounting Standards Board currently has projects underway that should result in new pronouncements and since this Canadian convergence initiative is very much in its infancy as of the date of these consolidated financial statements, the Company is assessing the impact of the ultimate adoption of IFRS on the Company's consolidated financial statements.

03 Capital Risk Management

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

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

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

04 Financial Risk Management

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

A) CURRENCY RISK

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials in US dollars at prices that are usually established at the order date. All of the Company's operations are based in Canada. As a result of this, the Company is exposed to currency risk to the extent that fluctuations in exchange rates are experienced. The amount of foreign exchange gain recorded in the third quarter 2008 was $26,000 as compared to $298,000 for the quarter ended September 30, 2007 (year-to-date September 30, 2008: $606,000 gain; September 30, 2007: $598,000 gain). The Company used derivative financial instruments to mitigate its exposure to currency risks in 2007 and into the first quarter 2008 (note 5). No such instruments were in place as at September 30, 2008.

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

Accounts receivable	$ 6,332,000
Bank indebtedness	7,777,000
Accounts payable	4,743,000
Long-term debt	2,573,000

B) CREDIT RISK

Credit risk is the risk of a financial loss to the Company if a customer or counter-party to a financial instrument fails to meet its contractual obligation. The Company manages credit risk for trade and other receivables through a financial review of the credit worthiness of the prospective customer along with credit monitoring activities. The majority of the Company's trade receivables reside with Boeing Commercial Airplane Group (Boeing), Bombardier Aerospace (Bombardier) and Cessna Aircraft Company (Cessna).

As at the balance sheet date 79% of the Company's trade accounts receivable are attributable to these three customers.

C) LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and financial leverage as outlined in note 3 to the unaudited consolidated financial statements.

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

The Company's operating line of credit is due on demand. Long-term debt repayments are as outlined in note 10.

D) INTEREST RATE RISK

The Company is exposed to interest rate risk on the utilized portion of its $17,000,000 operating line of credit at rates of bank prime plus 0.375%, 0.50%, 0.675% or 0.75% determined on a quarter basis according to specified measures of the ratio of debt to tangible net worth. The Company lowers interest rate costs by managing utilization of the operating line of credit to the lowest amount practical.

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

05 Financial Instruments

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

A) SALES CONTRACTS

A number of the Company's sales contracts have a price adjustment clause where the final sales price is determined by certain indices in a period prior to the date of sale. As a result, the final sales price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of sale. As at September 30, 2008, the Company has $32,784,000 (December 31, 2007: $66,026,000) of firmly committed orders that include price adjustment clauses of this nature. No gain or loss has been recorded in unrealized derivative gains for the quarter ended September 30, 2008 as compared to a $7,000 loss for the quarter ended September 30, 2007 (year-to-date September 30, 2008: $2,000 loss; September 30, 2007: $20,000 gain) as a result of the change in the fair value of the underlying embedded derivatives.

B) PURCHASE CONTRACTS

A number of the Company's purchase contracts have a price adjustment clause where the final purchase price is determined by certain indices in a period prior to the date of purchase. As a result, the final purchase price will change as these underlying indices change. This price adjustment clause is an embedded derivative that is recorded at fair value, with changes in fair value recorded in other income or expenses until the date of purchase. As at September 30, 2008, the Company has $777,000 (December 31, 2007: $3,000) of firmly committed purchases that include price adjustment clauses of this nature. No gain or loss has been recorded in unrealized derivative income for the quarter ended September 30, 2008 as compared to a $2,000 gain for the quarter ended September 30, 2007 as a result of the change in the fair value of the underlying embedded derivatives (year-to-date September 30, 2008: $Nil; September 30, 2007: $4,000 gain).

C) FOREIGN EXCHANGE FORWARD CONTRACTS

Foreign exchange exposure to US dollar sales, purchases, and related receivables and payables is in part managed by the use of foreign-exchange-forward contracts. On January 4, 2007, the Company entered into a 12-month USD$12,000,000 foreign-exchange-forward contract with the provider of its operating line of credit, of which a one-month USD$1,000,000 foreign-exchange-forward contract was executed during the quarter ended March 31, 2008. The Company does not have any unrealized foreign-exchange-forward contracts as at September 30, 2008 and consequently, no gain or loss has been recorded during the quarter ended September 30, 2008 as compared to a $11,000 gain for the quarter ended September 30, 2007 (year-to-date September 30, 2008: $Nil; September 30, 2007: $673,000).

D) OTHER ASSETS AND LIABILITIES

As at September 30, 2008, there are no net inflation derivatives assets or liabilities arising from the Company's sales and purchase contracts having price adjustment clauses within their terms (December 31, 2007: $138,000 net asset).

All other financial instruments have been recorded at cost or amortized cost, subject to regular impairment reviews, such as the investment in Eclipse Aviation Corporation (note 7).

06 Inventories

	SEPTEMBER 30, 2008	DECEMBER 31, 2007
Raw materials	**$ 5,338**	$ 6,454
Work in progress	**11,402**	10,546
Finished products	**661**	801
	17,401	17,801

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

07 Investment

On June 17, 2002, the Company acquired 5,264 Series D Preferred Stock of Eclipse Aviation Corporation for $1,527,000.

On December 31, 2004, the Company wrote down its investment by $768,000 to its then estimated fair value of $759,000.

On September 30, 2008, the Company wrote down its investment by a further $759,000 to an estimated fair value of $Nil.

08 Intangible Assets

The fair value of intangible assets arising from the December 31, 2007 acquisition of Comtek amounted to $2,620,000.

	SEPTEMBER 30, 2008			SEPTEMBER 30, 2007		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Customer relationships	**$ 1,320**	**$ 141**	**$ 1,179**	$ —	$ —	$ —
Order backlog	**130**	**99**	**31**	—	—	—
Trade name	**300**	**45**	**255**	—	—	—
Patents	**870**	**66**	**804**	—	—	—
	2,620	**351**	**2,269**	—	—	—

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

09 Goodwill

Goodwill in the amount of $571,000 arose on December 31, 2007 as a result of the Company's acquisition of Comtek Advanced Structures Ltd. (September 30, 2008: $571,000).

10 Long-Term Debt

	SEPTEMBER 30, 2008	DECEMBER 31, 2007
Convertible debenture due December 2009 **(A)**	**$ 4,197**	$ 4,497
Bank term loan **(B)**	**264**	331
Capital leases **(C)**	**3,898**	2,806
Accrued government royalties **(D)**	**777**	1,183
	9,136	8,817
Less: Current portion	**1,944**	2,056
	7,192	6,761

A) CONVERTIBLE DEBENTURE DUE DECEMBER 2009

During 1998, the Company issued an $8,000,000 convertible debenture; $3,000,000 of the convertible debenture was repaid prior to 2005. During 2006, the amount of the debenture was increased from $5,000,000 to $5,197,000 to include outstanding interest due thereon. The remaining outstanding debenture amount of $4,197,000 is convertible at the option of the holder (Export Development Canada) into 300,881 shares at a conversion price of $13.95. The Company can require conversion of the full amount of the debenture in the event that the weighted average trading price of the Company's shares on the Toronto Stock Exchange is greater than 125% of the conversion price for 20 consecutive days.

The debenture bears interest at 7.0% per annum.

Principal repayments are payable in 14 quarterly installments of $100,000 commencing on September 30, 2006 with the final installment of $3,797,000 due and payable on December 31, 2009.

B) BANK TERM LOAN

A Canadian chartered bank holds a term loan with Comtek in the amount of $264,000 as at September 30, 2008.

The terms and security of the term loan are as follows:

- Interest at a rate of 12% per annum.
- Commencing August 23, 2007, the principal will be repaid by 49 consecutive monthly installments of $7,500 each, followed with the final payment of $1,000 on September 23, 2011.
- All security shall be in form and substance satisfactory to the Lender and its counsel and shall be in form sufficient for registration or filing under all applicable laws. It includes a general security agreement over the assets of Comtek.

C) CAPITAL LEASES

There are various equipment leases that have a weighted average interest rate of 6.86% per annum. The leases are secured by way of a charge against specific assets. The leases are repayable in equal installments over periods up to 60 months. $2,738,000 of the leases are held in US dollars.

D) ACCRUED GOVERNMENT ROYALTIES

Royalties of $777,000 (December 31, 2007: $1,183,000) are payable to Technology Partnerships Canada. This balance is repayable by June 30, 2009.

11 Capital Stock

Authorized

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

Common shares issued or reserved:

	NUMBER OF SHARES	AMOUNT
December 31, 2006	27,836,627	$ 55,600
Share issue **(C)**		
Cash	1,069,398	1,680
Conversion from preferred shares	2,439,241	3,782
Acquisition of Comtek	99,458	129
Issuance costs	—	(67)
	3,608,097	5,524
Transfer from contributed surplus on exercise of options and warrants	—	70
December 31, 2007	31,444,724	61,194
Share issue **(B)**		
Cash	411,294	371
Conversion from Preferred Shares	28,571	50
Non-cash	430,340	387
	32,314,929	62,002
Transfer from contributed surplus on exercise of options and warrants	—	267
September 30, 2008	**32,314,929**	**62,269**

A) The Company has reserved a total of 300,881 common shares, the maximum number that may be exercised under the terms of the convertible debenture due December 2009 (note 10a).

B) During 2008, the Company issued 841,634 common shares from the following transactions:

I) EXERCISE OF WARRANTS

Holders of warrants exercised a total of 675,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 244,660 common shares at a price of $0.90, for gross proceeds of $221,000. The remaining 430,340 common shares issued at a price of $0.90 amounting to $387,000 was used to pay amounts owing.

II) EXERCISE OF OPTIONS

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

III) EXERCISE OF PREFERRED SHARES

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

C) During 2007, the Company issued 3,608,097 common shares from the following transactions:

I) EXERCISE OF WARRANTS

Holders of warrants exercised 50,000 share purchase warrants (issued on February 3, 2006 for a performance guarantee on certain production contracts) resulting in the issuance of 50,000 common shares at $0.90 per share for gross proceeds of $45,000.

II) EXERCISE OF OPTIONS

Holders of options exercised a total of 179,398 share purchase options resulting in the issuance of 167,398 shares at $1.08 per share and 12,000 shares at $1.40 per share for total gross proceeds of $198,000.

III) COMMON SHARE ISSUE

During the year ended December 31, 2007, the Company entered into a placement of 840,000 units at $2.20 per unit; 287,500 units were subscribed for by insiders of the Company. Each unit consists of one share and one warrant, where one warrant entitles the holder the right to purchase one additional share at $2.40 per share for a 24-month period from the closing date. Proceeds of the unit offering were split between capital stock and warrants.

IV) PREFERRED SHARE CONVERSION

Holders of preferred shares converted 378,200 preferred shares resulting in the issuance of 2,439,241 common shares at $1.55 per share.

V) COMMON SHARE ISSUE ON ACQUISITION OF COMTEK

On December 31, 2007, the Company issued 99,458 common shares to shareholders of the acquired Company at a value of $1.30 per share.

The costs of issuing the capital stock during 2007 amounted to $67,000 and were deducted from total proceeds of $1,680,000 to record $1,613,000 as capital stock.

D) Basic and Diluted Weighted Average Number of Common Shares.

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Weighted average shares outstanding	**32,312**	30,870	**32,085**	29,111
Effect of dilutive securities				
Incremental shares from share options and warrants	**—**	1,749	**—**	1,212
Shares issuable on conversion of preferred shares	**—**	4,197	**—**	3,925
Weighted average diluted shares outstanding	**32,312**	36,816	**32,085**	34,248

12 Preferred Shares

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

The preferred shares provide for a 9.25% per annum dividend, payable quarterly in cash on the last day of March, June, September and December with the first dividend payable on December 31, 2006. Dividends paid during the quarter ended September 30, 2008 amounted to $190,000 (September 30, 2007: $199,000), and $568,000 for the nine months ended September 30, 2008 (year-to-date September 30, 2007: $724,000).

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

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

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

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

The preferred shares will not be redeemable by the Company at any time prior to July 1, 2008.

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

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

Prior to September 30, 2008, holders of preferred shares converted 383,200 preferred shares resulting in 816,800 preferred shares remaining having a $7,622,000 book value.

13 Stock-Based Compensation

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

The fair value of options expense, for options granted in current and prior periods, amortized to earnings during the quarter ended September 30, 2008 was $19,000 (September 30, 2007: $25,000), and $57,000 for the nine months ended September 30, 2008 (year-to-date September 30, 2007: $174,000).

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

14 Defined Contribution Plan

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

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Defined contribution plan	**$ 324**	$ 310	**$ 1,061**	$ 976

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

15 Interest Expense and Financing Charges

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Interest on capital leases	**$ 59**	$ 58	**$ 192**	$ 85
Interest on other long-term debt	**84**	83	**248**	253
Interest on short-term debt	**322**	461	**1,124**	1,197
Net interest expense	**465**	602	**1,564**	1,535

16 Supplementary Cash Flow Information

A) Items not affecting cash:

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Accrued interest net of government contributions	**$ 315**	$ 363	**$ 971**	$ 767
Deferred revenues	**464**	39	**(609)**	(535)
Depreciation and amortization	**1,182**	757	**3,405**	2,302
Payment of fees via equity issue	**—**	—	**387**	—
Provision for loss-making contracts	**(332)**	229	**(675)**	258
Development cost amortization	**249**	102	**579**	365
Stock-based compensation	**19**	25	**57**	174
Unrealized derivative (gains) losses	**—**	7	**175**	(642)
Write-down of investment	**759**	—	**759**	—
Other items	**70**	(125)	**55**	(220)
	2,726	1,397	**5,104**	2,469

B) Changes in non-cash items:

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Accounts receivable	**$ 436**	$ (644)	**$ 347**	$ (3,392)
Inventories	**(1,146)**	244	**1,075**	860
Prepayments	**318**	(113)	**381**	(593)
Accounts payable and accrued liabilities	**733**	(3,341)	**134**	(2,372)
	341	(3,854)	**1,937**	(5,497)

C) Non-cash financing and investing activities:

	THREE MONTHS ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007	**2008**	2007
Assets acquired under capital leases	**$ 148**	$ 320	**$ 404**	$ 901
Conversion of preferred shares	**50**	1,775	**50**	3,782

17 Contingencies

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

18 Related-Party Transactions

During the year ended December 31, 2005, the Company entered into an agreement with a certain shareholder in consideration of mutual agreements with a Canadian chartered bank under which the shareholder guarantees the indebtedness of the Company to the Bank limited to $2,000,000. In connection with providing the limited guarantee on the operating line of credit, the Company will pay a 5% fee on the $2,000,000 limited guarantee calculated on a daily basis. Fees paid to a certain shareholder during the quarter ended September 30, 2008 amounted to $Nil (September 30, 2007: $Nil). Fees payable to a certain shareholder as at September 30, 2008 are $50,000 (September 30, 2007: $50,000). These fees are included in the Statements of Operations as interest expense and financing charges and amount to $25,000 for the quarter ended September 30, 2008 (September 30, 2007: $25,000).

On February 3, 2006, a performance guarantee was provided by certain shareholders on production contracts with a certain customer. Fees ranging to $20,000 per month were provided as consideration for the performance guarantee. Fees paid to certain shareholders during the quarter ended September 30, 2008 amounted to $Nil (September 30, 2007: $Nil). Fees payable to certain shareholders as at September 30, 2008 are $120,000 (September 30, 2007: $120,000). These fees are included in the Statements of Operations as cost of sales and amount to $60,000 for the quarter ended September 30, 2008 (September 30, 2007: $60,000).

Other related-party transactions are disclosed elsewhere in these financial statements (note 11b).

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

19 Economic Dependence and Segmented Information

A) Sales to three major customers, which comprise several programs and contracts, accounted for approximately 89.6% (September 30, 2007: 90.6%) of sales.

	THREE MONTHS ENDED SEPTEMBER 30				NINE MONTHS ENDED SEPTEMBER 30			
	2008		2007		**2008**		2007	
	REVENUE	**% OF TOTAL**	REVENUE	% OF TOTAL	**REVENUE**	**% OF TOTAL**	REVENUE	% OF TOTAL
Boeing	**$ 5,295**	**17.1**	$ 5,187	19.4	**$ 16,113**	**17.1**	$ 15,100	18.1
Bombardier	**6,304**	**20.4**	5,993	22.4	**20,667**	**21.9**	17,652	21.2
Cessna	**16,088**	**52.1**	13,037	48.8	**45,711**	**48.4**	43,510	52.2
Other	**3,207**	**10.4**	2,479	9.4	**11,943**	**12.6**	7,143	8.5
Total	**30,894**	**100.0**	26,696	100.0	**94,434**	**100.0**	83,405	100.0

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

20 Subsequent Event

Subsequent to the end of the third quarter 2008; the Company entered into the following forward-foreign-exchange contracts with its provider of the operating line of credit:

- The sale of USD$5,000,000 at an exchange rate of 1.1750 during the month of December 2008;
- The sale of USD$5,000,000 at an exchange rate of 1.1765 during the month of February 2009; and
- The sale of USD$10,000,000 at an exchange rate of 1.2454 during the month of June 2009.

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Vice President, Human Resources
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[1] Member of the Audit and Corporate Governance Committee
[2] Member of the Compensation and Nominating Committee
[3] Member of the Executive Committee
[*] Designates the Committee Chair

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