AVCORP

third quarter report 2015

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 and Bombardier. With more than 50 years of experience, over 385 skilled employees and 340,000 square feet of facilities at our Avcorp location in Delta BC which is dedicated to light weight metal manufacturing and assembly and at our Comtek location in Burlington ON which is dedicated to composites manufacturing and repair, 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. Our Burlington location also offers composite repairs for commercial aircraft. Avcorp Industries Inc. 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 September 30, 2015, and should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2014.

Description of Business

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

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

Avcorp is in compliance with industry standard quality requirements.

On July 20, 2015, the Company entered into a definitive agreement (the "Agreement") to acquire the US-based composite aerostructures division of a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL").

Pursuant to the Agreement, Avcorp will purchase the assets of the division of SGL's subsidiary Hitco Carbon Composites Inc. ("Hitco") which produces composite parts for commercial and military aerostructures.

The acquisition of Hitco's aerostructures composite division offers 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, will enhance Avcorp Group's ability to participate in large aerospace assembly programs which combine mixed material components. It is anticipated that significant operational efficiencies and better utilization of our existing assets will also be a resultant benefit of this acquisition. Combining the businesses should accelerate Avcorp's return to profitability.

Closing is subject to customary conditions, including finalization of other ancillary agreements, third party and regulatory approvals, and is anticipated to occur in Q4 2015.

Financial Overview

Quarterly Results

The following table provides selected unaudited quarterly condensed interim consolidated financial information for the eight most recent fiscal quarters to September 30, 2015 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 IAS 34, expressed in thousands of Canadian dollars except per share amounts)

	2015			2014				2013
FOR THE THREE MONTHS ENDED	**Sep 30**	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31
Revenue	**$21,610**	$20,369	$15,661	$13,744	$14,675	$21,134	$ 17,551	$ 17,159
Operating income (loss)	**(2,030)**	(1,125)	(2,672)	(3,848)	(2,321)	(472)	(1,397)	(2,637)
EBITDA[1]	**(556)**	(623)	(2,348)	(3,442)	(1,794)	(153)	(740)	(1,580)
Net income (loss)	**(2,053)**	(1,135)	(2,761)	(3,890)	(2,229)	(589)	(1,242)	(2,367)
EBITDA per share[1]								
Basic	**(0.00)**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)
Diluted	**(0.00)**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)
Net income (loss) per share								
Basic	**(0.01)**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)
Diluted	**(0.01)**	(0.00)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)	(0.01)
Long-term debt	**1,634**	1,542	1,434	943	152	223	48	67

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

Three and Nine Months Ended September 30, 2015 and 2014 Overview

During the quarter ended September 30, 2015 Avcorp Group revenues totaled $21,610,000 as compared to $14,675,000 revenue for the same quarter in the previous year; a significant 47% quarterly revenue increase for 2015 as compared to 2014. Both commercial and defence programs, for all customers, have experienced increased demand during the current quarter. Furthermore, new program introductions have added to current year revenues as the Group ramps up to full rates of production. Year-to-date 2015 revenues amount to $57,640,000 as compared to $53,360,000 for the same nine month period in 2014, an 8% increase.

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.

The Delta facility revenues have increased during the current quarter relative to the same quarter in the previous year: as deliveries for a certain existing defence program structure increased in order to meet current customer demand; further supplemented by successful start-up rotary wing aircraft defence program deliveries whose full rate production is occurring during the second half of 2015. Current quarter commercial jet and business jet aircraft structure deliveries increased over the same quarter in 2014, reflecting increased customer production rate demand and spare components sales.

Comtek has commenced the production introduction process of composite floor panels in supply to Bombardier Aerospace's Global 5000/6000 and Global 7000/8000 programs. New production program revenues have contributed $736,000 to the current quarter revenue growth over the same quarter in 2014. Full rate production for these programs will further establish the wholly owned subsidiary as a leading manufacturer of composite floor panels. Comtek has also developed long term relationships with aircraft operators ensuring that its growth in composite and metal aircraft structure repair revenues will continue to provide a strong operating cash flow from this market segment.

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 efforts have commenced producing value as noted in the recent contract awards for expanded scope of production on the Lockheed Martin F-35 Carrier Variant Outboard Wing, as well as production and supply of 767-2C Panoramic Camera Fairings, as part of The Boeing Company's KC-46 Tanker program. New program awards have increased order backlog by approximately $23 million. The Company is expending significant resources with a focused business development strategy to grow revenues via a targeted customer approach, and where beneficial, aligned with the Government of Canada Defence Procurement Strategy leveraging Industrial and Technological Benefits ("ITBs"). Concerted business development activities have now led to the Avcorp Delta and Burlington sites being down-selected for near term commercial and defence programs production contracts.

On July 20, 2015, the Company entered into a definitive agreement (the "Agreement") to acquire the US-based composite aerostructures division of Hitco Carbon Composites Inc. ("Hitco") a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL").

The aerostructures division of Hitco is a large carbon composites aerostructures manufacturer which produces and supplies composite aerostructures assemblies to aerospace markets. Its products comprise complex mold line structures such as beams, wing skins, tailcones, pressurized bulkheads and control surfaces. Hitco's products are sold within the commercial and defence aerospace industry.

The acquisition of Hitco's aerostructures composite division offers 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, will enhance Avcorp Group's ability to participate in large aerospace assembly programs which combine mixed material components.

The addition of the Hitco is anticipated to approximately double Avcorp's revenues in the immediate term. While not run as a separate accounting unit, the division has been operating at a loss.

Pursuant to the Agreement, Avcorp will purchase the assets of the division of SGL's subsidiary Hitco which produces composite parts for commercial and defence aerostructures. This includes all inventories, equipment, tooling and other fixed assets, intellectual property, contractual rights, goodwill, accounts receivable, and work in progress. The Corporation is not acquiring any assets of Hitco's materials division. Avcorp will be continuing operations at Hitco's current aerostructures facilities in Gardena, California.

Consideration for the acquisition of the assets is principally the assumption by Avcorp of current trade payables and ongoing contractual obligations of the aerostructures business of Hitco.

Avcorp will receive approximately USD42 million in cash and payment commitments. SGL will also provide further in kind supplies or payments of up to USD5 million over the period to December 31, 2016. The purchase consideration is subject to customary adjustments based on working capital of Hitco and certain contract pricing adjustments being negotiated by Hitco.

Closing is subject to customary conditions, including finalization of other ancillary agreements, third party and regulatory approvals, and is anticipated to occur in Q4 2015.

During the quarter ended September 30, 2015, the Avcorp Group recorded a loss from operations of $2,030,000 on $21,610,000 revenue, as compared to a $2,321,000 operating loss on $14,675,000 revenue for the same quarter in the previous year; and a net loss for the current quarter of $2,053,000 as compared to net loss of $2,229,000 for the quarter ended September 30, 2014.

During the current quarter Avcorp incurred expenses totaling $1,782,000 (year-to-date $2,273,000) in support of its current merger and acquisition initiatives. Specifically, the Company incurred costs in execution of the due diligence process related to constructing the legal framework, examining operations and conducting financial, as well as valuation assessments. Although one-time in nature, these costs are expected to continue through to close of the acquisition transaction.

Although recent customer contract awards will commence to increase facility utilization, there remain within operations significant levels of unutilized plant capacity within the Company's Delta, British Columbia facility. The Company has expensed $1,184,000 of overhead costs during the current quarter (September 30, 2014: $1,300,000) in respect of unutilized plant capacity. The amount of overhead costs expensed, as a result of unutilized capacity, will fluctuate from quarter to quarter as production in support of deliveries varies. Revenue growth would benefit Company profitability via a contribution to the recovery of fixed overhead expenditures. Avcorp is engaged with aerospace original equipment manufacturers ("OEM") as well as industry tier 1 suppliers in North America, Asia and Europe in collaborative production initiatives which support the Company's transition to composite manufacturing capabilities further leveraging existing production capacity and investments.

In addition to $1,184,000 expensed for unutilized plant capacity, the current quarter loss includes $123,000 in accretion of the fair value of warrants issued in conjunction with a term loan, as well as $244,000 in non-cash employee incentive costs. The current quarter loss included a $194,000 foreign exchange gain which resulted from holding foreign currency denominated cash, accounts receivable and accounts payable; while the loss for the quarter ended September 30, 2014 included a $108,000 foreign exchange gain.

Cash flows from operating activities during the quarter ended September 30, 2015 utilized $3,439,000 of cash as compared to utilizing $1,047,000 of cash during the quarter ended September 30, 2014. The primary use of cash from operations during the current quarter is due to recognition of revenue related to current quarter product deliveries for which the cash was received in a previous quarter, as well as a growth in accounts receivable attributable to increased revenues. As at September 30, 2015, the Company had $976,000 cash on hand (December 31, 2014: $3,159,000) and utilized $5,465,000 of its operating line of credit (December 31, 2014: $Nil). The Company has a working capital surplus of $2,981,000 as at September 30, 2015 which has decreased from the December 31, 2014 $7,205,000 surplus, as a result of cash utilized in operating activities. The Company's accumulated deficit as at September 30, 2015 is $71,622,000 (December 31, 2014: $65,673,000).

Revenue

Revenue for the quarter ended September 30, 2015 was $21,610,000 as compared to $14,675,000 for the quarter ended September 30, 2014. Current quarter revenues have increased relative to the same quarter in the previous year primarily as a result of an increase in quantities and values delivered for defence and commercial business jet programs in all facilities.

The Group's Delta BC facility generated revenues during the current quarter in excess of 45% ($5,348,000) greater than the same quarter in the previous year. Both commercial and defence market segments posted the strongest revenues for this facility in four quarters.

Increased production by Comtek of composite floor panels for delivery to Bombardier Aerospace's ("Bombardier") regional and business jets floors product line, along with strong sales into the composite floor panel aftermarket, have driven composite floor panel revenue during the current quarter to exceed Q3 2014 revenue by 99% for this market segment; new program revenues contributed $736,000 to this growth. In total Comtek's third quarter revenues have increased by 55% over the same quarter in 2014.

Avcorp Group's production has met and continues to exceed customer quality and delivery requirements.

Revenues from Avcorp Group customers are as follows.

REVENUE DISTRIBUTION

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars)

	Three months ended September 30				Nine months ended September 30			
	2015		2014		**2015**		2014	
	Revenue	**% of Total**	Revenue	% of Total	**Revenue**	**% of Total**	Revenue	% of Total
BAE Systems	**$ 4,688**	**21.7**	$ 2,403	16.4	**$ 11,590**	**20.1**	$ 14,014	26.3
Boeing	**8,262**	**38.2**	6,533	44.5	**22,074**	**38.3**	20,229	37.9
Bombardier	**4,193**	**19.4**	2,921	19.9	**12,132**	**21.0**	10,295	19.3
Other	**4,467**	**20.7**	2,818	19.2	**11,844**	**20.6**	8,822	16.5
Total	**21,610**	**100.0**	14,675	100.0	**57,640**	**100.0**	53,360	100.0

The Avcorp Delta BC facility is the single source supplier for the F-35 Carrier Variant Outboard Wing ("CV-OBW") assembly under contract with BAE Systems ("BAE"), and delivers directly to Lockheed Martin. The Outboard Wing is the foldable portion of the wing on the carrier version of the F-35 aircraft which allows for handling and storage of the aircraft on the aircraft-carrier's deck and hangers, while keeping its long-range and low-landing speed flight characteristics. The CV-OBW is regarded as one of the most complex assemblies that the Canadian aerospace industry contributes to the F-35 program. Production rates for the F-35 CV-OBW were reduced in 2015 relative to 2014. Production contracts have been secured through to May 2018, with discussions underway with the customer to secure constant production through 2021.

Shipments of large assemblies to Boeing Commercial Airplane Group ("Boeing CA"), primarily for the 737 commercial jet program, increased by 1% as a result of a timing of customer schedule during 2015, relative to 2014; current year run-rate production continues to exceed that of 2014. Concurrently, deliveries of fabricated parts to Boeing CA increased by 5%. The Company also delivered components to Boeing Defense, Space & Security ("Boeing DSS") for the Chinook CH47 helicopter. During 2015 the Company introduced into production a Chinook CH47 helicopter component in supply to Boeing DSS. This new program introduction is offsetting prior years' decrease in revenues as this program revenue stream commenced in the second quarter 2015. Current quarter revenue for this program amounts to $1,764,000 (2014: $4,000). The Avcorp Delta BC facility announced on October 26, 2015 that it has been awarded the production contract for the supply of 767-2C Panoramic Camera Fairing. 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 quarter ended September 30, 2014. Shipments of large assemblies for the CL605 business jet program increased by 20% during the current quarter, while Comtek experienced a 110% increase in its deliveries of composite floor panels to Bombardier. Avcorp Group's primary source of revenues from Bombardier in 2015 will continue to be from components for the CL605 and CL850 business jets, and composite floor panels for the CRJ and Q400 aircraft programs as well as commencement of production of composite floor panels in supply to Bombardier's Global 5000/6000 and Global 7000/8000 programs.

During the first half of 2015, there has been renewed customer demand for deliveries of Boeing 757 commercial jet 200 series wing adapter plugs, for retrofit to Aviation Partners Boeing, as well as additional aircraft retro-fit programs contributing to "Other" 2015 revenues exceeding 2014 amounts. Composite aircraft structure repair revenues out of Comtek continued with a strong performance, as third quarter revenues increased 5% over revenues in the same quarter the previous year.

Gross Profit

Gross profit (revenue less cost of sales) for the quarter ended September 30, 2015 was 14.6% of revenue as compared to 2.7% of revenue for the quarter ended September 30, 2014, an increase of $2,758,000.

Gross profit as a percentage of revenues has increased during the third quarter in 2015 relative to the same quarter in the previous year; partially as a result of comparative revenues having risen by 47% ($6,935,000) due to changes in customer delivery schedule and demand. This was mitigated by the continued scaling down of the plant production labour force which has caused temporary production inefficiencies as existing employees progress through the learning curve associated with differing program specific production processes. Recovery plans were commenced during the fourth quarter 2014 and have steadily progressed resulting in a 2015 third quarter recovery of production efficiencies to planned levels. Increased cost of US dollar denominated procured parts as well as internal quality assurance initiatives have additionally adversely impacted planned 2015 third quarter margins by $209,000. Conversely, the strengthening of the US dollar relative to the Canadian dollar has improved gross margins for US denominated sales by $856,000 for the current quarter relative to plan.

There remain within operations significant levels of unutilized plant capacity. The Company has expensed $1,184,000 of overhead costs during the current quarter (September 30, 2014: $1,300,000) in respect of unutilized plant capacity.

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

Administration and General Expenses

As a percentage of revenue, the administration and general expenses increased to 23.5% for the quarter ended September 30, 2015 from 17.6% for the quarter ended September 30, 2014. In absolute terms, administration and general costs increased by $2,489,000 during the current quarter relative to the same quarter in the prior year. During the current quarter Avcorp incurred expenses totaling $1,782,000 in support of its current merger and acquisition initiatives (September 30, 2014: $Nil). Specifically, the Company incurred costs in execution of the due diligence process related to constructing the legal framework, examining operations and conducting financial, as well as valuation assessments. Although, one-time in nature these costs are expected to continue through to close of the acquisition transaction.

Non-cash employee incentive costs amounting to $244,000 also contributed to the expenditure increase over the same quarter in 2014.

Foreign Exchange Gain or Loss

Avcorp Group recorded a $194,000 foreign exchange gain during the third quarter 2015 (September 30, 2014: $108,000 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 and liquidity.

EBITDA was negative $556,000 for the quarter ended September 30, 2015 compared to a negative EBITDA of $1,794,000 for the quarter ended September 30, 2014. During the current quarter Avcorp incurred expenses totaling $1,782,000 in support of its current merger and acquisition initiatives. Specifically, the Company incurred costs in execution of the due diligence process related to constructing the legal framework, examining operations and conducting financial, as well as valuation assessments. Although, one-time in nature these costs are expected to continue through to close of the acquisition transaction. An increase in revenues caused by changes in customer demand, for the current quarter, has reduced the operating losses and resultant negative EBITDA from the third quarter 2014. Significant levels of unutilized plant capacity, $1,184,000 overhead costs expensed in the third quarter 2015 (September 30, 2014: $1,300,000), is the primary cause for 2015 negative EBITDA.

EBITDA[1]

(unaudited, expressed in thousands of Canadian dollars)

	Three months ended September 30		Nine months ended September 30	
	2015	2014	**2015**	2014
Income (loss) for the quarter	**$ (2,053)**	$ (2,229)	**$ (5,949)**	$ (4,060)
Interest expense and financing charges	**220**	17	**315**	44
Income tax expense	**-**	-	**-**	-
Depreciation	**395**	417	**1,177**	1,192
Amortization of development costs	**882**	1	**930**	137
	(556)	(1,794)	**(3,527)**	(2,687)

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 September 30, 2015 was $219,000, net of $1,000 interest income (September 30, 2014: $1,000), as compared to net $16,000 expense for the quarter ended September 30, 2014. The increase in interest and financing charges for 2015 is primarily as a result of the Company recording the non-cash accretion of the fair value of warrants issued in the current quarter, as well as the increase of term debt with the purchase of equipment and tooling for new program introduction.

Income Taxes

Avcorp Group has not incurred a tax expense during the current quarter (September 30, 2014: $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 September 30, 2015 was $2,053,000 as compared to a $2,229,000 loss for the quarter ended September 30, 2014. The loss for the current quarter relative to 2014 has decreased, due in significant part to increased revenues on a relatively large fixed cost base of operations. Program gross margins have increased in the third quarter 2015 relative to 2014 due to favourable program sales mix and improved production stability and efficiencies in the Delta and Burlington facilities. The benefit of significantly improved gross margin has been diminished because Avcorp incurred expenses totaling $1,782,000 in support of its current merger and acquisition initiatives. Specifically, the Company incurred costs in execution of the due diligence process related to constructing the legal framework, examining operations and conducting financial, as well as valuation assessments. Although, one-time in nature these costs are expected to continue through to close of the acquisition transaction.

Liquidity and Capital Resources

Avcorp Group's operating line of credit provides for a total utilization of $12,000,000. Avcorp Group ended the current quarter with bank operating line utilization of $5,465,000 offset by $976,000 cash compared to utilization of $Nil with $3,159,000 cash on hand as at December 31, 2014. Based on net collateral provided to its bank, Avcorp Group is able to draw $7,484,000 on its operating line of credit as at September 30, 2015 (December 31, 2014: $4,351,000).

On March 26, 2015, the Company's bank extended its banking agreement from September 27, 2015 to March 31, 2016. As a condition to this extension in term, the bank required that a capital injection amounting to $5,000,000 be made by September 27, 2015. As noted below, the capital injection was received by the Company during the third quarter 2015.

On July 14, 2015, the Company's bank extended its banking agreement from March 31, 2016 to June 30, 2016.

On July 31, 2015, 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 $5,000,000. The Company received full funding from the loan in three advances, with the final amount received on September 23, 2015.

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on September 30, 2015. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

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

As consideration for the loan, the Company issued to Panta, 30,263,318 common share purchase warrants ("warrants"), each warrant 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 value of the warrants issued has been treated as a transaction cost and will be accreted over the loan term.

The Company is subject to the following terms:

- The Company shall not be obligated to make any principal or interest payments on advances of the loan until the maturity date, which is March 31, 2016;
- The Company shall be required to repay the indebtedness from the net cash proceeds of equity financing, meaning an offering of shares howsoever completed to raise up to $5,000,000 for the purpose of financing the Company's operations at its Delta, British Columbia site;
- The indebtedness may be prepaid in whole or in part at any time and from time to time without premium or penalty. Each such prepayment shall be credited first to accrued but unpaid interest and then to principal;
- Interest rate of 8% per year;
- Non-repayment at maturity date will result in the interest rate increasing to 15% per year; and
- Security for the loan will be subordinated to existing security requirements.

Equity Financing

Panta Canada B.V. has made the commitment to Avcorp to underwrite a $5,000,000 equity financing to occur within twelve months following date of execution of a March 31, 2015 commitment letter. The underwriting is subject to the following terms:

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

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

Cash Flows from Operating Activities

Cash flows from operating activities, before consideration of changes in non-cash working capital, utilized $411,000 of cash during the quarter ended September 30, 2015 as compared to utilizing $1,681,000 of cash during the same quarter in the previous year; lower operating losses recorded in 2015 contributing to the variance in cash flows.

Non-cash operating assets and liabilities utilized $3,028,000 of cash during the current quarter, compared to providing $634,000 of cash during the same quarter in 2014. The primary use of cash from operations during the current quarter is due to the growth in accounts receivable attributable to increased sales, as well as recognition of revenue related to current quarter product deliveries for which the cash was received in a previous quarter. Avcorp Group continues to closely monitor accounts receivable in order to ensure cash is collected on a timely basis.

For the quarter ended September 30, 2015, proceeds from customer funding of program working capital amounted to $4,110,000 net of $4,257,000 revenues recognized thereon (September 30, 2015: negative $147,000, September 30, 2014: $2,000); while deferred revenues recognized as income during the current quarter amounted to $1,082,000 (September 30, 2014: $Nil).

Cash Flows from Investing Activities

During the quarter ended September 30, 2015, Avcorp Group purchased capital assets totalling $240,000 as compared to $127,000 during the quarter ended September 30, 2014. Equipment purchases have been made to provide for new program revenues whose production is ramping up in 2015. Avcorp Group continues to minimize its capital expenditures in order to conserve cash, with only operation critical expenditures being made.

Additionally, the Company invested $114,000 during the current quarter (September 30, 2014: $511,000) in tooling and new program introduction. Current quarter expenditures primarily relate to investment in tooling and new program introduction costs for components on the Chinook CH47 Helicopter program, as well as non-recurring investments for the start-up of composite floor panel production in supply to Bombardier's Global 5000/6000 and Global 7000/8000 programs.

Cash Flows from Financing Activities

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

During the current quarter, the Company repaid long-term debt consisting of $106,000 of equipment financing (September 30, 2014: $67,000).

During the current quarter, the Company received $5,000,000 (September 30, 2014: $Nil) in debt funding from Panta Canada B.V. via a term loan which fulfilled the capital injection requirements stipulated by Avcorp Group's bank. Under the SADI program from the Government of Canada, the Company was able to secure $90,000 in project financing.

On September 30, 2015, the ratio of the Company's current assets to current liabilities was 1.12:1 (September 30, 2014: 1.60:1), with the debt to equity ratio at 0.85:1 (September 30, 2014: 0.02:1).

Contractual Obligations

PAYMENTS DUE BY PERIOD

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars)

	Total	2015	2016 – 2018	2019 – 2020	Post 2020
Finance lease obligations	**$ 353**	$ 74	$ 229	$ 50	$ -
Term loan	**5,426**	27	5,369	30	-
Other long-term obligations[1]	**1,186**	-	-	33	1,153
Purchase obligations[2]	**19,980**	7,235	12,324	421	-
Total contractual obligations	**26,945**	7,336	17,922	534	1,153

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 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 November 13, 2015, there were 302,633,184 common shares and 31,474,500 stock options issued and outstanding.

Common Shares

No common shares were issued by the Company during the third quarter 2015.

The Company is authorized to issue an unlimited number of common shares as well as an unlimited number of first preferred and second preferred shares, issuable in series, the terms of which will be determined by the Company's directors at the time of creation of each series. There were 302,633,184 common shares issued at September 30, 2015. The book value of common shares issued and outstanding as at September 30, 2015 was $79,921,000 (September 30, 2014: $77,910,000).

Accounting standards issued but not yet applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before February 1, 2015. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

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.

Operations Overview

Delivery and Quality Performance

Deliveries and quality performance as at September 30, 2015 were at customer required levels for BAE, Boeing, and Bombardier programs. Avcorp Group has achieved, and continues to maintain, top quality and delivery ratings for the majority of its programs.

Order Backlog

Avcorp Group operates within "general terms agreements" with its customers. These agreements are typically for five years or longer. The Company's agreements with Boeing Commercial Airplane Group extend from January 2013 to December 2017 and with Boeing Defense, Space and Security extending from 2013 into 2017 with established minimum base delivery quantity requirements. Agreements with BAE Systems (Operations) Limited extend to May 2018 and continue to generate additional sales order backlog. The Bombardier agreements extend for the life of the individual aircraft programs.

The Company defines order backlog as the value of purchase orders it expects to receive from these agreements based on manufacturers' projections and current degrees of exclusivity. The order backlog, as at September 30, 2015, is $188 million, ($19 million of which pertains to 2015), compared to $177 million as at June 30, 2015. The changes in order backlog are as follows:

- $22 million decrease in order backlog resulting from revenues recorded during the quarter ended September 30, 2015;
- $27 million increase in order backlog due to increases in the production rates and contract renewals for various existing programs, inclusive of the recently awarded expanded scope of production on the Lockheed Martin F-35 Carrier Variant Outboard Wing, as well as production and supply of 767-2C Panoramic Camera Fairings, as part of The Boeing Company's KC-46 Tanker program. New program awards have increased order backlog by approximately $23 million; and
- $6 million increase in order backlog resulting from change in the value of the Canadian dollar relative to the US dollar for the Company's US dollar denominated sales. Refer to comments on currency risk.

Supply Chain

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

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

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

Working Capital Utilization

Total current assets less total current liabilities were in a surplus position of $2,981,000 at September 30, 2015 and $8,797,000 at September 30, 2014. The decrease in working capital during 2015 was primarily due to cash utilized in operating activities.

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 September 30, 2015 was 385 (December 31, 2014: 369). Growth in the number of employees is primarily attributable to commencement of new production contracts. 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, 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 new program development and introduction;
- develop or enhance existing services and capabilities; or
- respond to competitive pressures.

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

Customer Contracts

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

BAE customer contracts extend to May 2018. 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 2015. 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 CL605 aircraft production requirements reduced significantly in 2014 relative to 2013. The production build rate has increased moderately in 2015 and the forecast is to remain flat through 2019.
- The market for defence aircraft flattened in 2015, after growth in previous years, due to general global budget challenges. Defence spending in North America and Europe is expected to decrease in the near term.
- The F-35 remains, on a global scale, one of the largest Defence Airplane programs for the foreseeable future.
- However, under the current North American Federal Governments' initiatives of cost controls regarding defence spending, there exists a risk that the customer demand for defence aircraft components is reduced or delayed.
- Offset opportunities created by Canadian Government procurement within military aerospace programs exists to provide additional revenue from this aerospace sector.

Competitors

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

Cost Reductions

Approximately 53% of Avcorp Group's cost of sales is related to labour and overhead and 47% related to procurement of raw materials and finished parts. The Company's wage rates are generally lower than its western European and north western United States competitors and higher than those in the south eastern United States, Asia, Eastern Europe and Mexico. On July 30, 2013 the Company and its labour force ratified a new six year collective agreement. The agreement was ratified by a two-thirds majority, with the new agreement expiring on March 31, 2019.

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

Composite Materials

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

On July 20, 2015, the Company entered into a definitive agreement (the "Agreement") to acquire the US-based composite aerostructures division of a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL").

The acquisition of Hitco's aerostructures composite division offers 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, will enhance Avcorp Group's ability to participate in large aerospace assembly programs which combine mixed material components.

Pursuant to the Agreement, Avcorp will purchase the assets of the division of SGL's subsidiary Hitco Carbon Composites Inc. ("Hitco") which produces composite parts for commercial and military aerostructures. This includes all inventories, equipment, tooling and other fixed assets, intellectual property, contractual rights, good will, accounts receivable, and work in progress. The Corporation is not acquiring any assets of Hitco's materials division. Avcorp will be continuing operations at Hitco's current aerostructures facilities in Gardena, California. While not run as a separate accounting unit, the division has been operating at a loss.

Closing is subject to customary conditions, including finalization of other ancillary agreements, third party and regulatory approvals, and is anticipated to occur in Q4 2015.

US Dollar Revenues

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

Outlook

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

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

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

Transactions with Related Parties

During the current quarter a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on September 30, 2015. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holdings B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the quarter ended September 30, 2015 amounted to $669,000 (September 30, 2014: $353,000). Fees payable to Panta Holdings B.V. as at September 30, 2015 are $363,000 (September 30, 2014: $325,000). These fees are included in the Condensed Interim Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $363,000 for the quarter ended September 30, 2015 (September 30, 2014: $325,000).

During the quarter ended September 30, 2015, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the quarter ended September 30, 2015 amounted to $155,000 (September 30, 2014: $42,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at September 30, 2015 are $Nil (September 30, 2014: $Nil). These fees are included in the Condensed Interim Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $138,000 for the quarter ended September 30, 2015 (September 30, 2014: $42,000).

On July 31, 2015, 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 $5,000,000. The Company received full funding from the loan in three advances, with the final amount received on September 23, 2015.

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on September 30, 2015. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

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

As consideration for the loan, the Company issued to Panta, 30,263,318 common share purchase warrants ("warrants"), each warrant 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 value of the warrants issued has been treated as a transaction cost and will be accreted over the loan term.

The Company is subject to the following terms:

- The Company shall not be obligated to make any principal or interest payments on advances of the loan until the maturity date, which is March 31, 2016;
- The Company shall be required to repay the indebtedness from the net cash proceeds of equity financing, meaning an offering of shares howsoever completed to raise up to $5,000,000 for the purpose of financing the Company's operations at its Delta, British Columbia site;
- The indebtedness may be prepaid in whole or in part at any time and from time to time without premium or penalty. Each such prepayment shall be credited first to accrued but unpaid interest and then to principal;
- Interest rate of 8% per year;
- Non-repayment at maturity date will result in the interest rate increasing to 15% per year; and
- Security for the loan will be subordinated to existing security requirements.

Panta Canada B.V. has made the commitment to Avcorp to underwrite a $5,000,000 equity financing to occur within twelve months following date of execution of a March 31, 2015 commitment letter. The underwriting is subject to the following terms:

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

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

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	2015	2014
Salaries and other short-term employee benefits	**$ 363**	$ 168	$ 1,128	$ 537
Contributions to defined contribution plan	**12**	10	34	27
Option-based awards	**244**	-	736	-
	619	178	1,898	564

Proposed Transactions

On July 20, 2015, the Company entered into a definitive agreement (the "Agreement") to acquire the US-based composite aerostructures division of a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL").

Pursuant to the Agreement, Avcorp will purchase the assets of the division of SGL's subsidiary Hitco Carbon Composites Inc. ("Hitco") which produces composite parts for commercial and military aerostructures. This includes all inventories, equipment, tooling and other fixed assets, intellectual property, contractual rights, good will, accounts receivable, and work in progress. The Corporation is not acquiring any assets of Hitco's materials division. Avcorp will be continuing operations at Hitco's current aerostructures facilities in Gardena, California. While not run as a separate accounting unit, the division has been operating at a loss.

Consideration for the acquisition of the assets is principally the assumption by Avcorp of current trade payables and ongoing contractual obligations of the aerostructures business of Hitco.

Avcorp will receive approximately USD42 million in cash and payment commitments. SGL will also provide further in kind supplies or payments of up to USD5 million over the period to December 31, 2016. The purchase consideration is subject to customary adjustments based on working capital of Hitco and certain contract pricing adjustments being negotiated by Hitco.

Closing is subject to customary conditions, including finalization of other ancillary agreements, third party and regulatory approvals, and is anticipated to occur in Q4 2015.

Critical Accounting Estimates and Judgment

The preparation of condensed interim consolidated financial statements in conformity with IAS 34 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.

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

- Carrying value of long-lived assets: The Company holds property, plant and equipment, on the condensed interim consolidated statements of financial position amounting to $8,174,000 (December 31, 2014: $8,204,000). The recoverability of these assets is dependent on the ability of the Company to generate sufficient cash flow from operations over the remaining useful life of the assets, which is contingent on, amongst other factors, the ability of the Company to replace known program losses with new programs as well as ramping up scheduled production for new production contracts. The recoverability of the carrying value of these assets is, in part, dependent on the estimates used in determining the expected period of future benefits over which to amortize. In addition, such recoverability is dependent on delivering to the scheduled production ramp-up for new programs, as well as dependent on market conditions including demand for such aircraft for which the Company provides its products.
- Recoverability of deferred tooling costs: The ability to defer tooling costs is dependent on the future recoverability of the amounts from cash flows generated by the related commercial operations as well as contractually required payments by customers. If operations perform below anticipated recoverable levels, the portion of deferred tooling costs that cannot be recovered is expensed immediately when known. At September 30, 2015, $3,582,000 (December 31, 2014: $3,303,000) in unamortized deferred tooling costs, which are expected to have a future economic benefit, are presented as Development costs in the condensed interim consolidated statements of financial position. Development costs of $569,000 (December 31, 2014: $569,000) are internally generated and not supported by customer advances.
- On a periodic basis the Company provides for its anticipated losses under existing contractual commitments to its customers by comparing its anticipated future costs of production to its contracted future revenues. As at September 30, 2015 the provision for anticipated losses was $61,000 (December 31, 2014: $190,000). The decrease in this provision from December 31, 2014 was primarily as a result of operational improvements in transitionary production inefficiencies as well as internal quality assurance initiatives.
- On a periodic basis the Company reviews its plant capacity and estimates the portion of its under-utilized overhead expenditures. The Company has expensed $1,184,000 of overhead costs during the current quarter (September 30, 2014: $1,300,000) in respect of unutilized plant capacity.

Financial Instruments and Other Instruments

Interest rate risk

The Company is exposed to interest rate risk on the utilized portion of its operating line of credit at rates of bank prime plus 0.5%. The maximum operating line of credit availability is $12,000,000 of which $5,465,000 is utilized as at September 30, 2015 (September 30, 2014: $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 September 30, 2015, with other variables unchanged, a 1% change in the bank prime interest rate would have a $14,000 (September 30, 2014: $Nil) impact on net earnings and cash flow.

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

Currency risk

The Company sells a significant proportion of its products in US dollars at prices which are often established well in advance of manufacture and shipment dates. In addition, the Company purchases a significant proportion of its raw materials and component parts 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 during the third quarter 2015 was $194,000 as compared to a $108,000 gain for the quarter ended September 30, 2014.

The Company had the following US dollar denominated balances:

FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014
Bank cash position	**US $ 255**	US $ 145
Accounts receivable	**4,567**	3,874
Accounts payable net of prepayments	**1,363**	1,453

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 $346,000 in net income for the quarter ended September 30, 2015 (September 30, 2014: $257,000 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 ("DSS"), Bombardier Aerospace ("Bombardier") and BAE Systems (Operations) Limited ("BAE"). During 2014 and 2015, there were no trade receivables written off by the Company in respect of these customers. The maximum exposure to credit risk is represented by the amount of accounts receivable in the condensed interim consolidated statements of financial position.

As at the condensed interim consolidated statements of financial position date 76% (September 30, 2014: 83%) of the Company's trade accounts receivable are attributable to these customers.

Liquidity Risk

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

Capital Risk

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

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

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

Other Items

Disclosure Controls and Procedures, and Internal Controls over Financial Reporting

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

The Chief Executive Officer and the Vice President, Finance, have evaluated the Company's disclosure controls and procedures, and internal controls over financial reporting, as of September 30, 2015 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 September 30, 2015, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Forward Looking Statements

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

report of **management**

The accompanying 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 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 IFRS. During the period covered by this report, there has been no change in internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars)

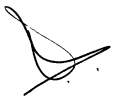
	September 30, 2015	December 31, 2014
ASSETS		
Current assets		
Cash (note 8)	**$ 976**	$ 3,159
Accounts receivable (note 4)	**11,240**	5,642
Inventories (note 5)	**14,022**	13,738
Prepayments and other assets	**1,002**	1,290
	27,240	23,829
Non-current assets		
Prepaid rent	**146**	146
Development costs (note 6)	**3,582**	3,303
Property, plant and equipment (note 7)	**8,174**	8,204
Total assets	**39,142**	35,482
LIABILITIES AND EQUITY		
Current liabilities		
Bank indebtedness (note 8)	**5,465**	-
Accounts payable and accrued liabilities (note 9)	**9,840**	8,549
Current portion of long-term debt (note 11)	**4,799**	293
Deferred program revenues (note 10)	**4,155**	7,782
	24,259	16,624
Non-current liabilities		
Deferred gain	**133**	168
Lease inducement	**296**	370
Long-term debt (note 11)	**1,634**	943
	26,322	18,105
Equity		
Capital stock (note 12)	**79,921**	79,921
Contributed surplus	**4,521**	3,129
Deficit	**(71,622)**	(65,673)
	12,820	17,377
Total liabilities and equity	**39,142**	35,482

Nature of operations (note 1)
Subsequent events (note 18)

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

Approved by the Board of Directors on November 13, 2015

David Levi
Chairman



Eric Kohn TD
Committee Chair,
Audit & Corporate Governance Committee

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

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars, except number of shares and per share amounts)

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Revenues	**$ 21,610**	$ 14,675	**$ 57,640**	$ 53,360
Cost of sales	**18,451**	14,274	**51,770**	48,898
Gross profit	**3,159**	401	**5,870**	4,462
Administrative and general expenses	**5,068**	2,579	**11,327**	8,220
Office equipment depreciation	**121**	143	**370**	432
Operating (Loss) Income	**(2,030)**	(2,321)	**(5,827)**	(4,190)
Finance costs – net (note 13)	**219**	16	**313**	36
Foreign exchange (gain) loss	**(194)**	(108)	**(189)**	(173)
(Gain) write-down on sale of equipment	**(2)**	-	**(2)**	7
(Loss) Income before income tax	**(2,053)**	(2,229)	**(5,949)**	(4,060)
Income tax expense	**-**	-	**-**	-
(Loss) Income and total comprehensive (loss) income for the period	**(2,053)**	(2,229)	**(5,949)**	(4,060)
(Loss) Earnings per share:				
Basic (loss) earnings per common share (note 16)	**(0.01)**	(0.01)	**(0.02)**	(0.01)
Diluted (loss) earnings per common share (note 16)	**(0.01)**	(0.01)	**(0.02)**	(0.01)
Basic weighted average number of shares outstanding (000's) (note 16)	**302,633**	283,083	**302,633**	282,732
Diluted weighted average number of shares outstanding (000's) (note 16)	**302,633**	283,083	**302,633**	282,732

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars)

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Cash flows from (used in) operating activities				
(Loss) Income before income tax	**$ (2,053)**	$ (2,229)	**$ (5,949)**	$ (4,060)
Adjustment for items not affecting cash:				
Accrued interest and government royalties	**96**	15	**190**	36
Depreciation	**395**	417	**1,177**	1,192
Development cost amortization	**882**	1	**930**	137
Provision for loss-making contracts	**(107)**	129	**(130)**	98
Provision for obsolete inventory	**41**	(9)	**194**	40
Stock based compensation	**244**	1	**736**	6
Fair value of warrants amortization	**123**	-	**123**	-
Other items	**(32)**	(6)	**(94)**	(82)
	(411)	(1,681)	**(2,823)**	(2,633)
Changes in non-cash working capital				
Accounts receivable	**(2,413)**	1,150	**(3,953)**	2,205
Inventories	**1,255**	(97)	**(348)**	2,341
Prepayments and other assets	**122**	137	**286**	338
Accounts payable and accrued liabilities	**(763)**	(558)	**986**	1,574
Deferred program revenues (note 10)	**(1,229)**	2	**(4,700)**	(6,919)
Net cash from (used in) operating activities	**(3,439)**	(1,047)	**(10,552)**	(3,094)
Cash flows from (used in) investing activities				
Proceeds from sale of equipment	**-**	21	**-**	589
Purchase of equipment	**(240)**	(127)	**(1,028)**	(917)
Payments relating to development costs and tooling	**(114)**	(511)	**(1,209)**	(1,916)
Net cash from (used in) investing activities	**(354)**	(617)	**(2,237)**	(2,244)
Cash flows from (used in) financing activities				
Increase (decrease) in bank indebtedness	**(784)**	-	**5,465**	-
Payment of interest	**(57)**	(15)	**(132)**	(36)
Proceeds from current and long term debt	**5,090**	-	**5,843**	-
Proceeds from issuance of common shares	**-**	-	**-**	142
Redemption of preferred shares and accrued dividends	**-**	-	**-**	(36)
Repayment of current and long-term debt	**(106)**	(67)	**(290)**	(390)
Net cash from (used in) financing activities	**4,143**	(82)	**10,886**	(320)
Net increase (decrease) in cash	**350**	(1,746)	**(1,903)**	(5,658)
Net foreign exchange difference	**(204)**	(101)	**(280)**	(174)
Cash - Beginning of period	**830**	3,027	**3,159**	7,012
Cash - End of period	**976**	1,180	**976**	1,180

Supplementary Cash Flow Information (note 14)

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited, prepared in accordance with IAS 34, expressed in thousands of Canadian dollars, except number of shares)

	Share capital				
	Shares	**Amount**	**Contributed surplus**	**Deficit**	**Total equity**
Balance December 31, 2013	280,391,152	77,681	3,593	(57,723)	23,551
Issue of common shares (notes 12b and c)	2,691,500	142	-	-	142
Stock based compensation expense	-	-	(6)	-	(6)
Transfer to share capital on exercise of stock options	-	87	(87)	-	-
Loss for the period	-	-	-	(4,060)	(4,060)
Balance September 30, 2014	283,082,652	77,910	3,500	(61,783)	19,627
Balance December 31, 2014	302,633,184	79,921	3,129	(65,673)	17,377
Stock-based compensation expense	-	-	736	-	736
Fair value of warrants issued	-	-	656	-	656
Loss for the period	-	-	-	(5,949)	(5,949)
Balance September 30, 2015	**302,633,184**	**79,921**	**4,521**	**(71,622)**	**12,820**

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.

We operate from two locations in Canada. Comtek Advanced Structures Ltd. ("Comtek"), a wholly owned subsidiary, is located in Ontario and is dedicated to composites manufacturing and repairs. Avcorp Industries Inc. is located in British Columbia and is dedicated to light weight metal manufacturing and assembly (note 18).

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 September 30, 2015 were authorized for issue in accordance with a resolution of its Board of Directors on November 13, 2015.

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") as issued by the International Accounting Standards Board ("IASB").

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 applied

The following is a brief summary of the new standards:

IFRS 9 – Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before February 1, 2015. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

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.

3. Expenses by Nature

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

Expenses by nature:

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Raw materials, purchased parts and consumables	**$ 9,166**	$ 6,264	**$ 24,217**	$ 22,820
Salary, wages and benefits	**8,432**	7,316	**24,923**	23,730
Contracted services and consulting	**889**	462	**2,198**	1,483
Legal and audit fees	**882**	46	**1,310**	277
Amortization of development costs	**882**	1	**930**	137
Other expenses and conversion of costs into inventory	**694**	490	**2,224**	1,876
Rent	**653**	618	**1,936**	1,907
Depreciation	**395**	417	**1,177**	1,192
Performance guarantee fees	**363**	325	**1,032**	999
Travel costs	**313**	152	**711**	435
Utilities	**284**	236	**823**	819
Transportation	**250**	225	**722**	626
Office equipment rental/maintenance	**168**	190	**506**	478
Plant equipment rental and maintenance	**96**	117	**219**	289
Insurance	**92**	102	**284**	307
Royalties	**81**	35	**255**	175
	23,640	16,996	**63,467**	57,550

4. Accounts Receivable

	September 30, 2015	December 31, 2014
Trade receivables	**$ 10,929**	$ 5,214
Input tax credits	**228**	332
Accrued receivables	**83**	96
	11,240	5,642

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

	September 30, 2015	December 31, 2014
US dollar	**US $4,567**	US $2,314
Canadian dollar	**5,145**	2,958

5. Inventories

	September 30, 2015	December 31, 2014
Raw materials	**$ 6,826**	$ 5,287
Work-in-progress	**6,348**	6,448
Finished products	**848**	2,003
	14,022	13,738

The amount of inventory expensed in cost of sales during the quarter ended September 30, 2015 amounted to $16,385,000 (September 30, 2014: $12,973,000). The carrying value of inventory pledged as security as at September 30, 2015 is $14,022,000 (December 31, 2014: $13,738,000).

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 September 30, 2015 provision for anticipated losses was $61,000 (December 31, 2014: $190,000). 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.

6. Development Costs

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

	September 30, 2015	December 31, 2014
Opening balance	**$ 3,303**	$ 1,240
Additions	**1,209**	2,211
Realized and amortization	**(930)**	(148)
	3,582	3,303

	September 30, 2015	December 31, 2014
Cost	**$ 7,629**	$ 6,420
Accumulated amortization	**(4,047)**	(3,117)
Net book amount	**3,582**	3,303

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

7. Property, Plant and Equipment

	Machinery and equipment	Computer hardware and software	Leasehold improvements	Total
Year ended December 31, 2014				
Opening net book amount	$ 6,627	$ 1,639	$ 438	$ 8,704
Additions	1,350	104	242	1,696
Disposals – cost	(1,111)	(72)	(26)	(1,209)
Disposals – accumulated depreciation	515	73	26	614
Depreciation charge	(856)	(540)	(205)	(1,601)
Closing net book amount	6,525	1,204	475	8,204
At December 31, 2014				
Cost	29,558	7,431	1,160	38,149
Accumulated depreciation	(23,033)	(6,227)	(685)	(29,945)
Net book amount	6,525	1,204	475	8,204
Quarter ended September 30, 2015				
Opening net book amount	6,525	1,204	475	8,204
Additions	889	164	94	1,147
Disposals – cost	(111)	-	-	(111)
Disposals – accumulated depreciation	111	-	-	111
Depreciation charge	(716)	(353)	(108)	(1,177)
Closing net book amount	6,698	1,015	461	8,174
At September 30, 2015				
Cost	30,336	7,595	1,254	39,185
Accumulated depreciation	(23,638)	(6,580)	(793)	(31,011)
Net book amount	6,698	1,015	461	8,174

The Company has $60,000 in commitments at September 30, 2015 to purchase property, plant and equipment in 2015.

Included in computer hardware and software are assets held under finance leases at a cost of $104,000 (December 31, 2014: $244,000) having accumulated depreciation of $77,000 (December 31, 2014: $164,000).

Included in machinery and equipment are assets held under finance leases at a cost of $952,000 (December 31, 2014: $812,000) having accumulated depreciation of $40,000 (December 31, 2014: $1,000).

8. Bank Indebtedness

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

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

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

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

On March 26, 2015, the Company's bank extended its banking agreement from September 27, 2015 to March 31, 2016. As a condition to this extension in term, the bank required that a capital injection amounting to $5,000,000 be made by September 27, 2015 (note 11b).

On July 14, 2015 the Company's bank further extended its banking agreement from March 31, 2016 to June 30, 2016.

The Company ended the current quarter with bank operating line utilization of $5,465,000 offset by $976,000 cash compared to utilization of $Nil with $3,159,000 cash on hand as at December 31, 2014. Based on net collateral provided to its bank, the Company is able to draw $7,484,000 on its operating line of credit as at September 30, 2015 (December 31, 2014: $4,351,000).

9. Accounts Payable and Accrued Liabilities

	September 30, 2015	December 31, 2014
Trade payables	**$ 5,897**	$ 3,922
Payroll-related liabilities	**2,913**	2,834
Performance guarantee fees	**363**	301
Restructuring provision	**206**	1,055
Other	**461**	437
	9,840	8,549

10. Deferred Program Revenues

	September 30, 2015	December 31, 2014
Opening balance	**$ 7,782**	$ 10,010
Additions	**8,725**	14,196
Realized	**(12,352)**	(16,424)
	4,155	7,782

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

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

11. Long-Term Debt

	September 30, 2015	December 31, 2014
Finance leases (a)	**$ 353**	$ 473
Term loans (b) (c)	**4,893**	-
SADI (d)	**1,187**	763
	6,433	1,236
Less: Current portion	**(4,799)**	(293)
	1,634	943

a) Finance Leases

There are various equipment leases that have a weighted average interest rate of 7.92% per annum. The leases are secured by way of a charge against specific assets. The leases are repayable in equal installments over periods up to 60 months.

b) Term Loan

On July 31, 2015, 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 $5,000,000. The Company received full funding from the loan in three advances, with the final amount received on September 23, 2015.

Panta Canada B.V. is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on September 30, 2015. Panta Canada B.V. is wholly owned by Panta Holdings B.V. Both companies are incorporated in The Netherlands and Mr. Jaap Rosen Jacobson is the sole shareholder of Panta Holdings B.V.

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

As consideration for the loan, the Company issued to Panta, 30,263,318 common share purchase warrants ("warrants"), each warrant 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 value of the warrants issued has been treated as a transaction cost and will be accreted over the loan term.

The Company is subject to the following terms:

- The Company shall not be obligated to make any principal or interest payments on advances of the loan until the maturity date, which is March 31, 2016;
- The Company shall be required to repay the indebtedness from the net cash proceeds of equity financing, meaning an offering of shares howsoever completed to raise up to $5,000,000 for the purpose of financing the Company's operations at its Delta, British Columbia site;
- The indebtedness may be prepaid in whole or in part at any time and from time to time without premium or penalty. Each such prepayment shall be credited first to accrued but unpaid interest and then to principal;
- Interest rate of 8% per year;
- Non-repayment at maturity date will result in the interest rate increasing to 15% per year; and
- Security for the loan will be subordinated to existing security requirements.

	September 30, 2015	December 31, 2014
Principle amount of term loan	**$ 5,000**	$ -
Accrued interest	**28**	-
Less: fair value of warrants issued	**(656)**	-
Accretion of fair value of warrants issued	**123**	-
Liability component	**4,495**	-

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

The term loan has been provided by a Canadian chartered bank. The loan has a four year term; it is secured by a general security agreement constituting a first ranking security interest in all personal property of the Company and a first ranking and specific interest in the equipment financed. Export Development Canada ("EDC") has guaranteed 50% of the aggregate borrowings outstanding under the loan. The fee associated to the guarantee provided by EDC is equal to 3% of 50% of the outstanding loan amount. Interest will be calculated and paid monthly at a rate of bank prime plus 1%. The loan will be repaid over 48 months by way of blended principal and interest payments. The balance outstanding for this term loan as at September 30, 2015 is $398,000.

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.

$1,187,000 was drawn on this facility as at September 30, 2015.

12. Capital Stock

a) No common shares were issued by the Company during the third quarter 2015.

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

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

13. Finance Costs

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Interest on finance leases	**$ 8**	$ 10	**$ 24**	$ 18
Interest on other long-term debt	**15**	-	**39**	8
Interest on short-term debt	**46**	7	**101**	18
Interest on related party debt	**28**	-	**28**	-
Accretion of fair value of warrants	**123**	-	**123**	-
Interest expense	**220**	17	**315**	44
Interest income	**(1)**	(1)	**(2)**	(8)
Net interest expense	**219**	16	**313**	36

14. Supplementary Cash Flow Information

Non-cash financing and investing activities:

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Equipment acquired under capital lease	**$ 35**	$ -	**$ 119**	$ 559
Uncollected deferred tooling revenue	**(2,540)**	1,954	**1,073**	1,994

15. Related Party Transactions

a) During the current quarter a performance guarantee was provided on production contracts with a certain customer by Panta Holdings B.V. whose wholly owned subsidiary, Panta Canada B.V., is Avcorp's majority shareholder owning approximately 66.1% of the issued and outstanding common shares on September 30, 2015. Both companies are incorporated in The Netherlands. Mr. Jaap Rosen Jacobson, a director of Avcorp is the sole shareholder of Panta Holding B.V. The performance guarantee is calculated as a percentage of revenues generated from production contracts with this certain customer. Accordingly, the fees will vary with fluctuations in sales to this certain customer. Fees paid, in that respect, to Panta Holdings B.V. during the quarter ended September 30, 2015 amounted to $669,000 (September 30, 2014: $353,000). Fees payable to Panta Holdings B.V. as at September 30, 2015 are $363,000 (September 30, 2014: $325,000). These fees are included in the Condensed Interim Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as cost of sales and amount to $363,000 for the quarter ended September 30, 2015 (September 30, 2014: $325,000).

b) During the quarter ended September 30, 2015, consulting services were provided by certain directors. Fees paid to certain directors, or companies with which they have beneficial ownership, during the quarter ended September 30, 2015 amounted to $155,000 (September 30, 2014: $42,000). Fees payable to certain directors or Companies with which they have beneficial ownership, as at September 30, 2015 are $Nil (September 30, 2014: $Nil). These fees are included in the Condensed Interim Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income as administrative and general expenses and amount to $138,000 for the quarter ended September 30, 2015 (September 30, 2014: $42,000).

c) Panta Canada B.V. has made the commitment to Avcorp to underwrite a $5,000,000 equity financing to occur within twelve months following date of execution of a March 31, 2015 commitment letter. The underwriting is subject to the following terms:

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

d) 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.

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Salaries and other short-term employee benefits	**$ 363**	$ 168	**$ 1,128**	$ 537
Contributions to defined contribution plan	**12**	10	**34**	27
Option-based awards	**244**	-	**736**	-
	619	178	**1,898**	564

e) Loans to related parties

The balance of loans receivable from key management as at September 30, 2015 is $15,000 (December 31, 2014: $15,000).

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

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

16. 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:

	Three months ended		Nine months ended	
FOR THE PERIOD ENDED SEPTEMBER 30	**2015**	2014	**2015**	2014
Weighted average number of common shares for basic earnings per share	**302,633**	283,083	**302,633**	282,732
Effect of dilution:				
Share options	**-**	-	**-**	-
Weighted average number of ordinary shares adjusted for the effect of dilution	**302,633**	283,083	**302,633**	282,732

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.

17. Economic Dependence and Segmented Information

a) Sales to three major customers for the quarter ended September 30, 2015, which comprise several programs and contracts, accounted for approximately 79.3% (September 30, 2014: 80.8%) of sales.

FOR THE PERIOD ENDED SEPTEMBER 30	Three months ended				Nine months ended			
	2015		2014		**2015**		2014	
	Revenue	**% of Total**	Revenue	% of Total	**Revenue**	**% of Total**	Revenue	% of Total
BAE Systems	**$ 4,688**	**21.7**	$ 2,403	16.4	**$ 11,590**	**20.1**	$ 14,014	26.3
Boeing	**8,262**	**38.2**	6,533	44.5	**22,074**	**38.3**	20,229	37.9
Bombardier	**4,193**	**19.4**	2,921	19.9	**12,132**	**21.0**	10,295	19.3
Other	**4,467**	**20.7**	2,818	19.2	**11,844**	**20.6**	8,822	16.5
Total	**21,610**	**100.0**	14,675	100.0	**57,640**	**100.0**	53,360	100.0

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

FOR THE PERIOD ENDED SEPTEMBER 30	Three months ended				Nine months ended			
	2015		2014		**2015**		2014	
	Revenue	**% of Total**	Revenue	% of Total	**Revenue**	**% of Total**	Revenue	% of Total
Canada	**$ 5,854**	**27.1**	$ 3,760	25.6	**$ 16,729**	**29.0**	$ 13,600	25.5
USA	**9,951**	**46.0**	8,003	54.6	**26,459**	**45.9**	23,541	44.1
Europe	**5,267**	**24.4**	2,589	17.6	**12,816**	**22.2**	15,043	28.2
Asia	**373**	**1.7**	261	1.8	**1,041**	**1.8**	924	1.7
Australia	**165**	**0.8**	61	0.4	**504**	**0.9**	223	0.4
Other	**-**	**0.0**	1	0.0	**91**	**0.2**	29	0.1
Total	**21,610**	**100.0**	14,675	100.0	**57,640**	**100.0**	53,360	100.0

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

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

FOR THE PERIOD ENDED SEPTEMBER 30	Three months ended				Nine months ended			
	2015		2014		**2015**		2014	
	Revenue	**% of Total**	Revenue	% of Total	**Revenue**	**% of Total**	Revenue	% of Total
Avcorp Industries Inc.	**$ 17,164**	**79.4**	$ 11,816	80.5	**$ 45,206**	**78.4**	$ 43,360	81.3
Comtek Advanced Structures Ltd.	**4,446**	**20.6**	2,859	19.5	**12,434**	**21.6**	10,000	18.7
Total	**21,610**	**100.0**	14,675	100.0	**57,640**	**100.0**	53,360	100.0

FOR THE PERIOD ENDED SEPTEMBER 30	Three months ended				Nine months ended			
	2015		2014		**2015**		2014	
	Income (loss)	**% of Total**	Income (loss)	% of Total	**Income (loss)**	**% of Total**	Income (loss)	% of Total
Avcorp Industries Inc.	**$ (2,790)**	**100.0**	$ (2,096)	94.0	**$ (7,350)**	**100.0**	$ (4,157)	100.0
Comtek Advanced Structures Ltd.	**737**	**0.0**	(133)	6.0	**1,401**	**0.0**	97	0.0
Total	**(2,053)**	**100.0**	(2,229)	100.0	**(5,949)**	**100.0**	(4,060)	100.0

FOR THE PERIOD ENDED	**September 30, 2015**		December 31, 2014	
	Total Assets	**% of Total**	Total Assets	% of Total
Avcorp Industries Inc.	**$ 30,441**	**77.8**	$ 30,629	86.3
Comtek Advanced Structures Ltd.	**8,701**	**22.2**	4,853	13.7
Total	**39,142**	**100.0**	35,482	100.0

18. Subsequent Events

On July 20, 2015, the Company entered into a definitive agreement (the "Agreement") to acquire the US-based composite aerostructures division of a subsidiary of Frankfurt-listed SGL Carbon SE ("SGL").

Pursuant to the Agreement, Avcorp will purchase the assets of the division of SGL's subsidiary Hitco Carbon Composites Inc. ("Hitco") which produces composite parts for commercial and military aerostructures. This includes all inventories, equipment, tooling and other fixed assets, intellectual property, contractual rights, good will, accounts receivable, and work in progress. The Corporation is not acquiring any assets of Hitco's materials division. Avcorp will be continuing operations at Hitco's current aerostructures facilities in Gardena, California. While not run as a separate accounting unit, the division has been operating at a loss.

Consideration for the acquisition of the assets is principally the assumption by Avcorp of current trade payables and ongoing contractual obligations of the aerostructures business of Hitco.

Avcorp will receive approximately USD42 million in cash and payment commitments. SGL will also provide further in kind supplies or payments of up to USD5 million over the period to December 31, 2016. The purchase consideration is subject to customary adjustments based on working capital of Hitco and certain contract pricing adjustments being negotiated by Hitco.

Closing is subject to customary conditions, including finalization of other ancillary agreements, third party and regulatory approvals.

notes

AVCORP INDUSTRIES INC.

BOARD OF DIRECTORS AND OFFICERS

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

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

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

Ray Castelli [1]
DIRECTOR
Chief Executive Officer
Weatherhaven
West Vancouver, British Columbia

Kees de Koning [3]
DIRECTOR
Nootdorp, The Netherlands

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

Elizabeth Otis [3]
DIRECTOR
Palm Springs, California

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

MANAGEMENT

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

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

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

Steven Archer
Vice President, Asia & Government Relations
Richmond, British Columbia

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

* Designates the Committee Chair

DIRECTORY

Legal Counsel

McMillan LLP
Barristers & Solicitors
Vancouver, British Columbia

Auditors

Ernst & Young LLP
Chartered Accountants
Vancouver, British Columbia

Shares Listed

Toronto Stock Exchange
Symbol AVP

Registrar and Transfer Agent

CST Trust Company
Vancouver, British Columbia

Bank

Royal Bank of Canada
Richmond, British Columbia

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