

**Magellan Aerospace Corporation**  
**Third Quarter Report**  
**September 30, 2004**

Magellan Aerospace Corporation (the "Corporation" or "Magellan") is listed on the Toronto Stock Exchange under the symbol MAL. The Corporation is a diversified supplier of components to the aerospace industry. Through its network of facilities throughout North America and the United Kingdom, Magellan supplies leading aircraft manufacturers, airlines and defence agencies throughout the world.

**Financial Results**

On November 9, 2004 the Corporation released its financial results for the third quarter of 2004. The results are summarized as follows:

Expressed in thousands, except per share amounts	Three Months Ended September 30			Nine Months Ended September 30		
	2004	2003	PERCENTAGE CHANGE	2004	2003	PERCENTAGE CHANGE
Revenues	\$ 142,727	\$ 102,179	39.7%	\$ 436,509	\$ 341,221	27.9%
Net Income (Loss)	\$ 2,156	\$ 143	1407.7%	\$ 3,004	\$ (14,388)	-
Net Income (Loss) Per Share	\$ 0.01	\$ (0.02)	-	\$ (0.01)	\$ (0.27)	-
EBITDA*	\$ 13,043	\$ 9,623	35.5%	\$ 33,870	\$ 5,181	453.7%
EBITDA* Per Share	\$ 0.16	\$ 0.14	14.3%	\$ 0.39	\$ 0.08	425.0%

**This quarterly statement contains certain forward-looking statements that reflect the current views and/or expectations of the Corporation with respect to its performance, business and future events. Such statements are subject to a number of risks, uncertainties and assumptions which may cause actual results to be materially different from those expressed or implied. The Corporation assumes no future obligation to update these forward-looking statements.**

**\*The Corporation has included certain measures in this quarterly statement, including EBITDA, the terms for which are not defined under Canadian generally accepted accounting principles. The Corporation defines EBITDA as earnings before interest, taxes and depreciation and amortization. The Corporation has included these measures, including EBITDA, because it believes this information is used by certain investors to assess financial performance and EBITDA is a useful supplemental measure as it provides an indication of the results generated by the Corporation's principal business activities prior to consideration of how these activities are financed and how the results are taxed in various jurisdictions.. Although the Corporation believes these measures are used by certain investors (and the Corporation has included them for this reason), these measures are unlikely to be comparable to similarly titled measures used by other companies.**

## **Management's Discussion and Analysis**

Revenues in the third quarter of 2004 were \$142.7 million, an increase of \$40.5 million (39.7%) over the same period in 2003. The increase in revenues was due to both the inclusion of Magellan's UK operations, acquired in the fourth quarter of 2003, which contributed \$26.9 million in sales, as well as increases in Magellan's North American operations. Sales in North America were higher in the third quarter of 2004 compared to the same period one year ago by \$13.6 million before taking into account the effect of the lower US/Canadian exchange rate. Because of the stronger Canadian dollar in 2004 compared to 2003, reported sales were approximately \$4.9 million lower than if the exchange rate experienced in 2003 had stayed constant. On this basis, which reflects the volume of components delivered, sales increased in the third quarter of 2004 by 18.1% in Magellan's North American operations, and 44.4% overall.

On a year to date basis, revenues were \$436.5 million, an increase of \$95.3 million (27.9%) over the year-to-date period in 2003. Magellan's UK operations represent \$75.4 million of this increase, while the remaining \$19.9 million relates to increased revenues from Magellan's existing businesses in North America. Again, the change in foreign exchange rates muted the increase; using the exchange rates experienced in the 2003 year-to-date period, revenues in 2004 would have been approximately \$20.2 million higher than the same period in 2003 at Magellan's North American operations.

Gross margins for the third quarter of 2004 were \$15.5 million, or 10.8% of sales compared to gross margin of \$11.6 million or 11.3% of sales in the third quarter of 2003. Several items have contributed to the lower gross margin percentage. First, the increase in sales was a result of several new programs which are experiencing lower margins than typical mature programs. Second, the natural hedge of raw materials which were denominated in the same currency as sales, works inefficiently with rapid changes in foreign exchange rates, as goods purchased during higher exchange rates were being relieved at a time when sales denominated in the same currency were being recorded at lower exchange rates. Finally, while the Corporation hedges the majority of the excess US dollar cash flow in Canada, the level at which it was hedged in 2004 was less advantageous than 2003. The impact of realized exchange rate changes on gross margin in the third quarter of 2004 compared to the same period in 2003 was a reduction of \$1.3 million in gross margin. The Corporation's challenge is to adopt changes at the operational level to retain its competitiveness in spite of the change in exchange rates.

Administrative and general expenses were \$7.9 million (5.5% of sales) in the third quarter of 2004, compared to \$8.1 million (7.9% of sales) in the third quarter in 2003. Included in administrative and general expenses for the quarter ended September 30, 2004, was an unrealized foreign exchange gain of \$3.6 million on translation of US denominated liabilities on the Corporation's Canadian divisions as well as a gain of \$1.6 million, realized on the sale of land in the United Kingdom. Excluding these items administrative and general expenses were \$13.1 million (9.2% of sales). There was no foreign exchange gain or loss in the third quarter of 2003. In the year to date period, administrative and general expenses were \$32.2 million in 2004, compared to \$23.9 million in 2003. The higher level of administrative and general expenses in the year-to-date period in 2004 was due to the inclusion of Magellan's UK operations, a foreign exchange gain of \$5.5 million in the year-to-date period in 2003 and higher levels of activity across Magellan's North American operations.

Interest expense in the third quarter of 2004 was \$4.2 million, compared to \$3.2 million in the third quarter of 2003. Interest expense in the third quarter of 2004 includes an amount of \$0.4 million which represents discounts on the sale of receivables and an amount of \$0.5 million related to the GE 414 deferred liability. For the year to date period, interest expense was \$11.6 million in 2004, compared to \$8.7 million in 2003. The increase in interest is due primarily to higher interest rates.

The provision for income taxes in the third quarter of 2004 was \$1.2 million (effective tax rate of 35.6%), compared to \$0.1 million (effective tax rate of 36.4%) in the third quarter of 2003. For the year to date period, a provision for income taxes of \$1.7 million (effective tax rate of 35.7%) in 2004 has been recorded, compared to a income tax recovery of \$7.6 million (effective tax rate of 34.6%) in 2003. The overall effective tax rate has changed because of various different tax rates in the different jurisdictions in which the Corporation operates.

The Corporation recorded net income in the third quarter of 2004 of \$2.2 million, which after deducting convertible debenture interest and accretion charges of \$1.6 million represents \$0.01 per share. For the year-to-date period, the Corporation's net income was \$3.0 million, which after deducting convertible debenture interest and accretion charges of \$4.4 million result in a loss of \$0.02 per common share.

### **Liquidity and Capital Resources**

In the third quarter of 2004, the Corporation generated cash from operations of \$5.4 million, compared to \$4.5 of cash generated in the third quarter of 2003. After taking into account the effects of foreign exchange rate changes, non-cash working capital balances increased by \$1.8 million, which included an \$7.3 million decrease in inventory. For the year-to-date period, the Corporation has generated \$4.9 million from operations.

During the second quarter the Corporation issued rights to all existing shareholders, entitling them to purchase common shares of the Corporation at a price of \$2.75. These rights expired in September, 2004 and resulted in the issuance of 11.3 million common shares, generating net proceeds of \$31.1 million. Of these proceeds \$15.5 million was used to permanently repay long-term debt and the balance was retained for general corporate purposes. As well, the Corporation made, in the third quarter of 2004, further repayments of long-term debt of \$5.0 million, in accordance with its existing repayment schedule.

As the Corporation's long-term credit agreement expires in July, 2005, the balance of the debt due under this arrangement, including a final payment of \$35.0 million has been moved to current liabilities. The Corporation is in discussion with its bankers and expects to execute a plan to refinance its debt within the next six months. The Corporation is in compliance with all of its banking covenants.

During the third quarter, the Corporation sold certain receivables under securitization arrangements with third parties. In the third quarter, the Corporation sold a total of \$57.1 million of receivables. A discount of \$0.42 million relating to these sales reflecting an annualized discount rate of 2.9% has been recorded as interest expense in the third quarter.

In the third quarter of 2004, the Corporation invested \$3.9 million in capital expenditures to modernize its facilities and enhance its manufacturing capabilities. Also during the third quarter of 2004, the Corporation sold land and facilities in the United Kingdom for proceeds of approximately \$1.6 million. As this land was acquired with the Mayflower assets in the fourth quarter of 2003, its cost base had been recorded at zero and the entire proceeds have been recorded as a gain on sale of assets.

### **Update on Closure of Fleet Industries**

In February of 2003, the Corporation announced its decision to cease operations at its Fleet Industries plant in Fort Erie. Management is working toward a final closure date. The Corporation estimates that the reserve recorded for closure costs remains adequate.

### **Risk Factors**

The majority of the Corporation's revenues and operating income is derived from the aviation industry. The Corporation's aerospace operations are focused on engineering and manufacturing aircraft components on new aircraft, selling spare parts and performing repair and overhaul services on existing aircraft components. Therefore, the Corporation's business is directly affected by economic factors and other trends that affect the Corporation's customers in the aerospace industry. Economic and other factors, both internal to the aviation industry or general economic factors that might affect the aerospace industry indirectly may have an adverse impact on the Corporation's results from operations.

In addition, growth in the demand for products manufactured by the Corporation has resulted in an increased requirement for working capital. The Corporation needs to access the capital markets to fund this growth, as indicated in the Liquidity and Capital Resources discussion above. There is no assurance that the Corporation will be able to raise additional capital required on financial terms acceptable to it.

A more extensive analysis of related risk factors, which covers both generic and in some cases more specific items, is contained in the Corporation's Annual Information Form.

**Summary**

The commercial airline industry continues to add capacity in spite of high fuel costs, however results are quite mixed with some low-cost airlines showing profits, while some other airlines undergoing significant restructuring in order to stay in operation. Both Boeing and Airbus, however have released build schedules for the next three years which indicate increases in single aisle aircraft – on which Magellan has significant exposure. The amount of modern aircraft in storage has been reduced to the point where it is more feasible to order new aircraft than to draw them out of storage. Magellan is evaluating several new opportunities to manufacture components on the Boeing 7E7, as well as additional business on Joint Strike Fighter. The business jet market continues to recover steadily, and this is being seen with increases in orders from various engine manufacturers. As well, continued demand for military spares and overhauls will support the Corporation's business for the next few years.

On behalf of the Board



**N. Murray Edwards**  
**Chairman**  
November 5, 2004



**Richard A. Neill**  
**President and Chief Executive Officer**

The attached financial statements have not been reviewed by the Corporation's external auditors.

**MAGELLAN AEROSPACE CORPORATION**  
**CONSOLIDATED STATEMENTS OF**  
**INCOME (LOSS) AND RETAINED**  
**EARNINGS**  
 (unaudited)

(expressed in thousands of dollars, except per share amounts)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<u><b>2004</b></u>	<u>2003</u>	<u><b>2004</b></u>	<u>2003</u>
Revenues	\$ <b>142,727</b>	\$ 102,179	\$ <b>436,509</b>	\$ 341,221
Cost of revenues	<u><b>127,274</b></u>	<u>90,616</u>	<u><b>388,043</b></u>	<u>297,312</u>
Gross profit	<u><b>15,453</b></u>	<u>11,563</u>	<u><b>48,466</b></u>	<u>43,909</u>
Administrative and general expenses	<b>7,859</b>	8,111	<b>32,225</b>	23,926
Interest	<b>4,248</b>	3,227	<b>11,571</b>	8,699
Unusual item (note 2)	<u>—</u>	<u>—</u>	<u>—</u>	<u>33,273</u>
	<u><b>12,107</b></u>	<u>11,338</u>	<u><b>43,796</b></u>	<u>65,898</u>
Income (loss) before income taxes	<b>3,346</b>	225	<b>4,670</b>	(21,989)
Income taxes - current	<b>175</b>	148	<b>433</b>	1,019
- future (recovery)	<u><b>1,015</b></u>	<u>(66)</u>	<u><b>1,233</b></u>	<u>(8,620)</u>
	<u><b>1,190</b></u>	<u>82</u>	<u><b>1,666</b></u>	<u>(7,601)</u>
<b>Net income (loss) for the period</b>	<u><b>2,156</b></u>	<u>143</u>	<u><b>3,004</b></u>	<u>(14,388)</u>
Retained earnings, beginning of the period	<b>121,148</b>	125,869	<b>122,853</b>	142,762
Convertible debenture charges	<u><b>(1,674)</b></u>	<u>(1,751)</u>	<u><b>(4,227)</b></u>	<u>(4,113)</u>
Retained earnings, end of the period	\$ <u><b>121,630</b></u>	\$ 124,261	\$ <u><b>121,630</b></u>	\$ 124,261
Income (loss) per common share				
Basic	<u><b>\$ 0.01</b></u>	<u>(0.02)</u>	<u><b>(0.02)</b></u>	<u>(0.27)</u>
Diluted	<u><b>\$ 0.00</b></u>	<u>(0.02)</u>	<u><b>(0.02)</b></u>	<u>(0.27)</u>

**MAGELLAN AEROSPACE CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
 (unaudited)

(expressed in thousands of dollars)

	<b>September 30</b> <b><u>2004</u></b>	December 31 <u>2003</u>
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 5,897	\$ 3,888
Accounts receivable	86,006	82,726
Inventories	292,511	275,233
Prepaid expenses and other	9,191	7,785
Future income tax asset	<u>8,574</u>	<u>5,101</u>
<b>Total current assets</b>	<b><u>402,179</u></b>	<b><u>374,733</u></b>
Capital assets	282,238	300,076
Other	42,376	42,414
Future income tax asset	<u>39,493</u>	<u>34,862</u>
	<b><u>\$ 766,286</u></b>	<b><u>\$ 752,085</u></b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank indebtedness	\$ 84,262	\$ 71,808
Accounts payable and accrued charges	110,430	99,261
Current portion of long-term debt (note 3)	<u>53,845</u>	<u>24,558</u>
<b>Total current liabilities</b>	<b><u>248,537</u></b>	<b><u>195,627</u></b>
Long-term debt (note 3)	11,461	70,845
Future income tax liability	94,500	87,692
Other long-term liabilities	32,641	46,105
<b>Shareholders' equity</b>		
Capital stock (note 4)	213,918	182,733
Convertible debentures	71,302	69,902
Retained earnings	121,630	122,853
Foreign exchange translation	<u>( 27,703)</u>	<u>(23,672)</u>
<b>Total shareholders' equity</b>	<b><u>379,147</u></b>	<b><u>351,816</u></b>
	<b><u>\$ 766,286</u></b>	<b><u>\$ 752,085</u></b>

**MAGELLAN AEROSPACE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
 (unaudited)

(expressed in thousands of dollars)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
<b>OPERATING ACTIVITIES</b>				
Income (loss) for the period	\$ 2,156	\$ 143	\$ 3,004	\$ (14,388)
Add (deduct) items not affecting cash				
Depreciation and amortization	5,449	6,171	17,629	18,471
Gain on sale of capital assets	(1,610)	—	(1,610)	—
Stock option expenses	156	—	156	—
Unusual item (note 2)	—	—	—	33,273
Future income taxes (recoveries)	1,015	(66)	1,233	(8,620)
	<b>7,166</b>	6,248	<b>20,412</b>	28,736
Net change in non-cash working capital				
items relating to operating activities	(1,765)	(1,780)	(14,059)	(29,126)
Cash provided by (used in) operating activities	<b>5,401</b>	4,468	<b>6,353</b>	(390)
<b>INVESTING ACTIVITIES</b>				
Purchase of capital assets	(3,874)	(2,803)	(18,329)	(5,725)
Proceeds on sale of capital assets	1,645	—	16,657	—
Increase in other assets	(2,090)	(193)	(751)	(847)
Cash used in investing activities	<b>(4,319)</b>	(2,996)	<b>(2,423)</b>	(6,572)
<b>FINANCING ACTIVITIES</b>				
(Decrease) increase in bank indebtedness	(2,372)	6,401	14,046	(499)
Net repayments of long-term debt	(20,696)	(5,665)	(29,724)	(54,548)
Issue of convertible debentures	—	—	—	67,950
Interest on convertible debentures	(1,495)	(1,495)	(4,454)	(4,348)
Issue of common shares	31,110	46	31,185	116
Decrease in long-term liabilities	(9,255)	(1,147)	(13,641)	(2,770)
Cash (used in) provided by financing activities	<b>(2,708)</b>	(1,860)	<b>(2,588)</b>	5,900
Effect of exchange rate changes on cash	(418)	172	667	(301)
(Decrease) increase in cash	<b>(2,044)</b>	(216)	<b>2,008</b>	(1,362)
Cash, beginning of period	<b>7,941</b>	2,484	<b>3,888</b>	3,630
Cash, end of period	<b>\$ 5,897</b>	\$ 2,268	<b>\$ 5,897</b>	\$ 2,268

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

(expressed in thousands of dollars except share and per share data)

**1. ACCOUNTING POLICIES**
**Basis of Presentation**

The accompanying unaudited consolidated financial statements have been prepared by the Corporation in accordance with accounting principles generally accepted in Canada on a basis consistent with those followed in the most recent audited consolidated financial statements. These unaudited consolidated financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and notes included in the Corporation's Annual Report for the year ended December 31, 2003.

**2. UNUSUAL ITEM**

During 2003, the Corporation announced its decision to cease operations at its Fleet Industries plant in Fort Erie, Ontario. Management has estimated the potential costs and losses resulting from this decision and has recorded a one-time charge to net earnings in 2003 of \$33,273; however as this amount involves estimates, the ultimate amount of the charge could be materially different from the amounts.

**3. LONG-TERM DEBT**

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	\$	\$
Term bank loan	52,213	83,217
Other non-bank loans	7,608	7,114
Obligations under capital leases	5,485	5,072
	65,306	95,403
Less current portion	53,845	24,558
	11,461	70,845

The term bank loan bears interest at bankers' acceptance or LIBOR rates, plus 2.25% to 4.50%, and has a maturity date of July 26, 2005. Included in the term bank loan are amounts due in U.S. dollars of \$29,638 [2003 - \$66,005].

**4. CAPITAL STOCK**

The following table summarizes information on share capital and related matters at September 30, 2004:

	<b>Outstanding</b>	<b>Exercisable</b>
Common shares	90,704,838	
Common shares stock options	2,971,000	1,230,900

The weighted average number of common shares outstanding during the three month and nine month periods ended September 30, 2004 was 80,624,147 and 79,775,716, respectively.



## 5. STOCK-BASED COMPENSATION PLAN

The Corporation has an incentive stock option plan, which provides for the granting of options for the benefit of employees and directors. The maximum number of options for common shares that remain to be granted under this plan is 2,399,703. Options are granted at an exercise price that will be the market price of the Corporation's common shares at the time of granting. Options normally have a life of 5 years with vesting of 20% at the end of the first, second, third, fourth and fifth years from the date of the grant. In addition, certain business unit income tests must be met in order for the option holder's entitlement to fully vest.

The Corporation accounts for stock options issued after January 1, 2003 using the fair value method, which gives rise to compensation expense. The Corporation issued no stock options in 2003. In the second quarter of 2004, the Corporation issued 1,103,500 stock options.

The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

- Risk free interest rate 3.65%
- Expected volatility 33%
- Expected average life of the options 4 years
- Expected dividend yield 0%
- Option exercise price \$3.00 per share

The Black-Scholes option valuation model used by the Corporation to determine fair values was developed for use in estimating the fair value of freely traded options, which are fully transferable and have no vesting restrictions. The Corporation's employee stock options are not transferable, cannot be traded and are subject to vesting restrictions and exercise restrictions under the Corporation's black-out policy which would tend to reduce the fair value of the Corporation's stock options. Changes to the subjective input assumptions used in the model can cause a significant variation in the estimate of the fair value of the options.

An amount of \$156 for stock option expenses was included in determining income for the third quarter of 2004.

The Corporation accounts for stock options issued before January 1, 2003 using the intrinsic value method, which does not give rise to compensation expense. Under Canadian generally accepted accounting principles, the Corporation is required to disclose compensation expense for the stock option plan as if the Corporation had elected the fair value method at the grant date.

For purposes of pro-forma disclosures, The Corporation's net income (loss) attributable to its common shares and basic and diluted earnings (loss) per common share would have been:

	<b>Nine months ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
Net income (loss)	\$ 3,004	\$ (14,388)
Less: Convertible debenture charges	(4,227)	(4,113)
Less: Pro forma compensation expense	(207)	(207)
<b>Pro forma net income (loss)</b>	<b>\$ (1,430)</b>	<b>\$ (18,708)</b>
Pro forma income (loss) per common share		
Basic	\$ (0.02)	\$ (0.28)
Diluted	\$ (0.02)	\$ (0.28)

## 6. SEGMENTED INFORMATION

The Corporation is organized and managed as a single business segment being aerospace and the Corporation is viewed as a single operating segment by the chief operating decision maker for the purposes of resource allocations and assessing performance.

Domestic and foreign operations consist of the following:

	Nine months ended September 30,							
	2004				2003			
	Canada	USA	UK	Total	Canada	USA	UK	Total
	\$	\$	\$	\$	\$	\$	\$	\$
<b>Revenue</b>								
Domestic	<b>80,884</b>	<b>127,396</b>	<b>70,101</b>	<b>278,381</b>	56,431	136,793	—	193,224
Export	<b>144,048</b>	<b>8,771</b>	<b>5,309</b>	<b>158,128</b>	127,769	20,228	—	147,997
<b>Total revenue</b>	<b>224,932</b>	<b>136,167</b>	<b>75,410</b>	<b>436,509</b>	184,200	157,021	—	341,221
<b>Capital assets</b>	<b>129,685</b>	<b>144,619</b>	<b>7,934</b>	<b>282,238</b>	148,924	158,253	—	307,177

Revenue is attributed to countries based on the location of the customers and capital assets are based on the country in which they are located.

## 7. FOREIGN EXCHANGE TRANSLATION

Unrealized translation adjustments, which arise on the translation to Canadian dollars of assets and liabilities of the Corporation's self-sustaining foreign operations, resulted in an unrealized currency translation loss of \$4,031 for the period ending September 30, 2004 [2003 – a loss of \$20,933], which is reflected as foreign exchange translation on the consolidated balance sheets and has no impact on net income. The unrealized loss during the nine-month period ending September 30, 2004 resulted from the strengthening of the Canadian dollar against the U.S. dollar and the Great Britain Pound Sterling.

## 8. SUPPLEMENTARY INFORMATION

Foreign exchange gain (on the conversion of foreign currency denominated working capital balances and debt) in 2004 was \$476 [2003 – gain of \$4,907].

### For additional information contact:

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