

# MAGELLAN

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2013

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# Magellan Aerospace Corporation – Management’s Discussion & Analysis

## June 30, 2013

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This Management’s Discussion and Analysis (“MD&A”) of the financial condition and results of operations of Magellan Aerospace Corporation (“Magellan” or the “Corporation”) has been prepared in accordance with International Financial Reporting Standards (“IFRS”). The MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the three and six months ended June 30, 2013, and the audited annual consolidated financial statements for the year ended December 31, 2012 (available on SEDAR at [www.sedar.com](http://www.sedar.com)). This MD&A provides a review of the significant developments that have impacted the Corporation’s performance during the three month period ended June 30, 2013 relative to the three month period ended June 30, 2012. The information contained in this report is as at August 8, 2013. All financial references are in Canadian dollars unless otherwise noted.

The MD&A contains forward-looking information that represents the Corporation’s internal projections, expectations, estimates or beliefs concerning, among other things, future operating results and various components thereof or the Corporation’s future economic performance. These statements relate to future events or future performance. All statements other than statements of historical facts may be forward-looking statements. In particular and without limitation there are forward looking statements under the heading “Overview”, “Results of Operations”, “Liquidity and Capital Resources”, “Future Changes in Accounting Policies” and “Outlook”. In some cases, forward-looking statements can be identified by terminology such as “may”, “will”, “should”, “expects”, “projects”, “plans”, “anticipates”, and similar expressions. The projections, estimates and beliefs contained in such forward-looking statements are based on management’s assumptions relating to the production performance of Magellan’s assets and competition throughout the aerospace industry and continuation of the current regulatory and tax regimes in the jurisdictions in which the Corporation operates, and necessarily involve known and unknown risks and uncertainties, including the business risks discussed in this MD&A, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. Except as required by law, the Corporation does not undertake to update any forward-looking information in this document whether as to new information, future events or otherwise.

The MD&A presents certain non-IFRS financial measures to assist readers in understanding the Corporation’s performance. Non-IFRS financial measures are measures that either exclude or include amounts that are not excluded or included in the most directly comparable measures calculated and presented in accordance with Generally Accepted Accounting Principles (“GAAP”). Throughout this discussion, reference is made to EBITDA (defined as net income before interest, income taxes, depreciation and amortization), which the Corporation considers to be an indicative measure of operating performance and a metric to evaluate profitability. EBITDA is not generally accepted earnings measures and should not be considered as an alternative to net income (loss) or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating this measure, the Corporation’s EBITDA may not be directly comparable with similarly titled measures used by other companies. Reconciliations of EBITDA to net income (loss) reported in accordance with IFRS are included in this MD&A.

## 1. Overview

A summary of Magellan’s business and significant updates

Magellan is a diversified supplier of components to the aerospace industry and in certain circumstances for power generation projects. Through its wholly owned subsidiaries, Magellan designs, engineers, and manufactures aeroengine and aerostructure components for aerospace markets, advanced products for defence and space markets, and complementary specialty products. The Corporation also supports the aftermarket through supply of spare parts as well as performing repair and overhaul services and supplies in certain circumstances parts and equipment for power generation projects.

The Corporation’s strategy has been to focus on several core competencies within the aerospace industry. These include precision machining of a wide variety of aerospace material, composites, complex high technology magnesium and aluminum alloy castings, repair and overhaul technologies and design of structures. The Corporation is now seeking to leverage these core competencies by achieving growth in applications where these abilities are critical in meeting customer needs.

# Magellan Aerospace Corporation – Management’s Discussion & Analysis

## June 30, 2013

### Business Update

In the second quarter of 2013 Magellan once again attended the Paris Air Show. Attendance at major air shows such as this enables Magellan to refine its strategies based on meetings with senior executives of major customers and suppliers and to benchmark itself against its global competition.

During this show, Magellan announced the signing of a Memorandum of Agreement (“MOA”) with BAE systems for horizontal tail assemblies on the F-35 Lightning II program. This MOA contractually confirms previous announcements that Magellan will be eligible to produce more than 1,000 sets of horizontal tails for the Conventional Take Off and Landing variant of the F-35 program over the next twenty years.

The commercial aerospace market growth continues in contrast to a reduction of activity in the defence aerospace market due to the decline in global defence spending. Also Magellan is experiencing a reduction in defence revenue as a result of sequestration in the United States; however, its growing commercial aerospace business is helping to offset any overall negative effect on the Corporation’s business.

New entries in the commercial aircraft market and demands from low-cost airlines on their aircraft suppliers are causing major aircraft manufacturers to aggressively approach suppliers such as Magellan for concessions to help them reduce their suppliers’ costs. Magellan is responding to these requests by leveraging its demonstrated successes in the Corporation’s overall performance to customer requirements, driven largely by the implementation of the Magellan Operating System™. Complementing these efforts, the Corporation is reducing costs by improving efficiencies supported by investments in new technologies and by developing a supply base in emerging markets. In that regard, in July 2013, the Corporation closed an investment of 50% in a parts supplier based in India. This investment provides the Corporation with access to a lower cost parts supplier and is the second aerospace contractor in which the Corporation has invested in India.

Additionally, in this quarter, Magellan continued its dialogue with key customers to explore new business opportunities in space and communications, Wire Strike and the Power Generation business.

For additional information, please refer to the “Management’s Discussion and Analysis” section of the Corporation’s 2012 Annual Report available on [www.sedar.com](http://www.sedar.com).

## 2. Results of Operations

A discussion of Magellan’s operating results for second quarter ended June 30, 2013

The Corporation reported higher revenue in its Aerospace segment and lower revenue in its Power Generation Project segment in the second quarter of 2013 when compared to the second quarter of 2012. Gross profit and net income for the second quarter of 2013 were \$28.8 million and \$11.2 million, respectively, an increase from the second quarter of 2012 gross profit of \$22.5 million and net income of \$8.9 million.

### Consolidated Revenue

Overall, the Corporation’s consolidated revenues grew by 12.1% when compared to the second quarter of 2012.

	Three month period ended June 30			Six month period ended June 30		
Expressed in thousands of dollars	2013	2012	Change	2013	2012	Change
Aerospace	<b>189,863</b>	162,834	16.6%	<b>371,678</b>	328,826	13.0%
Power Generation Project	—	6,505	(100.0)%	<b>3,478</b>	27,360	(87.3)%
Total revenues	<b>189,863</b>	169,339	12.1%	<b>375,156</b>	356,186	5.3%

Consolidated revenues of \$189.9 million for the second quarter ended June 30, 2013 were higher than \$169.3 million in the second quarter of 2012. Higher volumes of production contributed to increased revenues in the Aerospace segment offset by the lower revenues earned in the Power Generation Project segment. As the Corporation moves through 2013, revenues earned from the Power Generation Project will continue to decrease on a year over year basis and are expected to be significantly lower than 2012 unless the Corporation receives further contracts in this area.

## Magellan Aerospace Corporation – Management’s Discussion & Analysis June 30, 2013

### Aerospace Segment

Revenues for the Aerospace segment were as follows:

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2013	2012	Change	2013	2012	Change
Canada	<b>73,388</b>	71,790	2.2%	<b>146,774</b>	147,512	(0.1)%
United States	<b>60,395</b>	51,162	18.0%	<b>118,048</b>	100,692	17.2%
Europe	<b>56,080</b>	39,882	40.6%	<b>106,856</b>	80,622	32.5%
Total revenues	<b>189,863</b>	162,834	16.6%	<b>371,678</b>	328,826	13.0%

Consolidated Aerospace revenues for the second quarter of 2013 of \$189.9 million were 16.6% higher than revenues of \$162.8 million in the second quarter of 2012. Revenues in Canada in the second quarter of 2013 increased 2.2% from the same period in 2012. The increase was mainly attributed to increased volumes on proprietary products, partially offset by the decline in volumes in the defence market. Revenues increased by 18.0% in the United States in the second quarter of 2013 in comparison to the second quarter of 2012 primarily due to increased volumes on several of the Corporation’s commercial aircraft programs and the movement of the stronger US dollar in comparison to the CDN dollar during the same periods in 2013 and 2012. The business acquisition of John Huddleston Engineering Limited (“JHE”) in the third quarter of 2012 and higher volumes of production on the Airbus statement of work contributed to a healthy 40.6% quarter-over-quarter increase in revenues in Europe in the second quarter of 2013 over revenues in the same period in 2012.

### Power Generation Project Segment

Revenues for the Power Generation Project segment were as follows:

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2013	2012	Change	2013	2012	Change
Power Generation Project	—	6,505	(100.0)%	<b>3,478</b>	27,360	(87.3)%
Total revenues	—	6,505	(100.0)%	<b>3,478</b>	27,360	(87.3)%

The Ghana Power Generation Project (the “Project”) was substantially completed as at March 31, 2013. Additional revenues may be recorded as the Corporation continues to support the commercial operation of the Project; however, it is expected that revenues from the Power Generation Project segment will decrease on a year over year basis unless the Corporation receives further contracts in this area.

### Gross Profit

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2013	2012	Change	2013	2012	Change
Gross profit	<b>28,770</b>	22,536	27.7%	<b>53,582</b>	48,073	11.5%
Percentage of revenues	<b>15.2%</b>	13.3%		<b>14.3%</b>	13.5%	

Gross profit of \$28.8 million (15.2% of revenues) was reported for the second quarter of 2013 compared to \$22.5 million (13.3% of revenues) during the same period in 2012. Gross profit in the second quarter of 2013 increased over the same period in 2012 as gross profit in the second quarter of 2012 was affected by a work stoppage at the Corporation’s Haley location, and in the second quarter of 2013 the Corporation experienced positive changes in its product mix.

### Administrative and General Expenses

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2013	2012	Change	2013	2012	Change
Administrative and general expenses	<b>11,329</b>	9,231	22.7%	<b>22,064</b>	19,092	15.6%
Percentage of revenues	<b>6.0%</b>	5.5%		<b>5.9%</b>	5.4%	

Administrative and general expenses were \$11.3 million (6.0% of revenues) in the second quarter of 2013 compared to \$9.2 million (5.5% of revenues) in the second quarter of 2012. The increase is partially a result of the acquisition of JHE in August 2012, which increased general and administrative expenses by approximately \$0.5 million for the three months ended June 30, 2013 versus the same period in 2012 and partially due to a growth in the Corporation’s administration support services.

## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

#### Other

	Three month period ended June 30		Six month period ended June 30	
	2013	2012	2013	2012
Expressed in thousands of dollars				
Foreign exchange (gain) loss	(22)	100	926	(46)
Loss on disposal of property, plant and equipment	182	8	214	11
Total other	160	108	1,140	(35)

Other expense of \$0.2 million in the second quarter of 2013 consisted of realized and unrealized foreign exchange gains and losses on the disposal of property, plant and equipment.

#### Interest Expense

	Three month period ended June 30		Six month period ended June 30	
	2013	2012	2013	2012
Expressed in thousands of dollars				
Interest on bank indebtedness and long-term debt	1,737	1,938	3,547	3,894
Accretion charge for borrowings and long-term debt	(176)	206	(22)	406
Discount on sale of accounts receivable	171	156	331	295
Total interest expense	1,732	2,300	3,856	4,595

Interest expense of \$1.7 million in the second quarter of 2013 was lower than the second quarter of 2012 amount of \$2.3 million, as interest on bank indebtedness and long-term debt decreased mainly due to lower principal amounts outstanding during the second quarter of 2013 than those in the second quarter of 2012. Increased long-term bond rates resulted in a recovery of previously recorded accretion expense in the second quarter of 2013 when compared to the same quarter in the prior year.

#### Provision for Income Taxes

	Three month period ended June 30		Six month period ended June 30	
	2013	2012	2013	2012
Expressed in thousands of dollars				
Expense of current income taxes	1,337	872	2,541	1,785
Expense of deferred income taxes	3,049	1,132	4,803	2,232
Total expense of income taxes	4,386	2,004	7,344	4,017
Effective tax rate	28.2%	18.4%	27.7%	16.4%

The Corporation recorded an income tax expense of \$4.4 million in the second quarter of 2013 as compared to an income tax expense of \$2.0 million in the second quarter of 2012. The change in effective tax rates quarter over quarter is a result of a changing mix of income across the different jurisdictions in which the Corporation operates and the reduction in deferred income tax in the second quarter of 2012, due to the recognition of previously unrecognized deferred tax assets, which did not recur in the second quarter of 2013.

### 3. Selected Quarterly Financial Information

A summary view of Magellan’s quarterly financial performance

	2013		2012 <sup>1</sup>			2011		
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Expressed in millions of dollars, except per share amounts								
Revenues	189.9	185.3	186.4	161.4	169.3	186.8	173.3	161.6
Income before taxes	15.5	11.0	18.0	18.0	10.9	13.5	13.8	10.4
Net Income	11.2	8.0	21.8	14.9	8.9	11.5	16.6	8.6
Net Income per share								
Basic	0.19	0.14	0.37	0.26	0.15	0.20	0.90	0.47
Diluted	0.19	0.14	0.37	0.26	0.15	0.20	0.31	0.17
EBITDA	25.6	21.3	28.6	27.7	21.2	23.0	29.6	20.8

<sup>1</sup>Certain 2012 figures have been restated due to the implementation of IFRS 11, *Joint Arrangements* and revised IAS 19, *Employee Benefits*. See the “Changes in Accounting Policies” section on page 9 of this report.

## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

The Corporation reported its highest quarterly revenues in the second quarter of 2013. Revenues and net income reported in the quarterly information was impacted by the fluctuations in the Canadian dollar exchange rate in comparison to the US dollar and British Pound. The US dollar/Canadian dollar exchange rate in the second quarter of 2013 fluctuated reaching a low of 1.0030 and a high of 1.0515. During the second quarter of 2013, the British Pound relative to the Canadian dollar fluctuated reaching a low of 1.5328 and a high of 1.6209. The movement of exchange rates between the second quarter of 2013 and the second quarter of 2012 had minimal impact on revenues in the second quarter of 2013. Net income in the third quarter of 2012 was higher than the first two quarters of 2012 as the Corporation recognized an after tax gain on bargain purchase of \$7.4 million on the acquisition of JHE as the consideration paid was lower than the fair value of the identifiable tangible assets acquired at the time of purchase. Net income for the fourth quarter of 2012 and 2011 of \$21.8 million and \$16.6 million respectively was higher than other quarterly net income disclosed in the table above. In the fourth quarter of 2011 the Corporation recognized a reversal of previous impairment losses against intangible assets relating to various commercial aircraft programs. In addition, in both the fourth quarter of 2011 and 2012 the Corporation recognized previously unrecognized investment tax credits and other deferred tax assets as the Corporation determined that it will be able to benefit from these assets.

#### 4. Reconciliation of Net Income to EBITDA

A description and reconciliation of certain non-IFRS measures used by management

In addition to the primary measures of earnings and earnings per share (basic and diluted) in accordance with IFRS, the Corporation includes certain measures in this quarterly statement, including EBITDA (earnings before interest expense, income taxes and depreciation and amortization). The Corporation has provided this measure because it believes this information is used by certain investors to assess financial performance and that 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 the various jurisdictions. Each of the components of this measure are calculated in accordance with IFRS, but EBITDA is not a recognized measure under IFRS, and the Corporation’s method of calculation may not be comparable with that of other companies. Accordingly, EBITDA should not be used as an alternative to net income as determined in accordance with IFRS or as an alternative to cash provided by or used in operations.

	Three month period ended June 30		Six month period ended June 30	
Expressed in thousands of dollars	2013	2012	2013	2012
Net income	11,163	8,893	19,178	20,404
Interest	1,732	2,300	3,856	4,595
Taxes	4,386	2,004	7,344	4,017
Depreciation and amortization	8,311	7,996	16,485	15,185
EBITDA	25,592	21,193	46,863	44,201

EBITDA for the second quarter of 2013 was \$25.6 million, compared to \$21.2 million in the second quarter of 2012, an increase of 20.8% on a year-over-year basis. Increased revenues and gross profits resulted in increased EBITDA for the current quarter when compared to the same period in 2012.

#### 5. Liquidity and Capital Resources

A discussion of Magellan’s cash flow, liquidity, credit facilities and other disclosures

The Corporation’s liquidity needs can be met through a variety of sources including cash on hand, cash provided by operations, short-term borrowings from its credit facility and accounts receivable securitization program, and long-term debt and equity capacity. Principal uses of cash are for operational requirements and capital expenditures. Based on current funds available and expected cash flow from operating activities, management believes that the Corporation has sufficient funds available to meet its liquidity requirements at any point in time. However, if cash from operating activities is lower than expected or capital projects exceed current estimates, or if the Corporation incurs major unanticipated expenses, it may be required to seek additional capital in the form of debt or equity or a combination of both.

## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

#### Cash Flow from Operations

	Three month period ended June 30		Six month period ended June 30	
Expressed in thousands of dollars	2013	2012	2013	2012
(Increase) decrease in accounts receivable	(1,113)	1,462	(22,647)	(22,432)
Increase in inventories	(6,624)	(5,321)	(7,464)	(15,616)
(Increase) decrease in prepaid expenses and other	(231)	279	(2,263)	(962)
Increase (decrease) in accounts payable, accrued liabilities and provisions	4,366	(7,538)	6,018	14,613
Changes to non-cash working capital balances	(3,602)	(11,118)	(26,356)	(24,397)
Cash provided by operating activities	17,747	3,706	11,749	8,791

In the quarter ended June 30, 2013, the Corporation generated \$17.7 million in cash in its operations, compared to \$3.7 million generated in the second quarter of 2012. Cash was generated mainly by an increase in net income and in accounts payable, accrued liabilities and provisions, offset by increases in accounts receivable and inventories.

#### Investing Activities

	Three month period ended June 30		Six month period ended June 30	
Expressed in thousands of dollars	2013	2012	2013	2012
Purchase of property, plant and equipment	(4,217)	(8,481)	(8,318)	(12,463)
Proceeds of disposals of property plant and equipment	81	39	127	42
Increase in intangibles and other assets	(1,731)	(3,025)	(4,443)	(8,191)
Cash used in investing activities	(5,867)	(11,467)	(12,634)	(20,612)

In the second quarter of 2013, the Corporation invested \$4.2 million in property, plant and equipment to upgrade and enhance capabilities for current and future programs and \$1.7 million in intangibles and other assets, largely related to deposits placed on new property, plant and equipment to be acquired.

#### Financing Activities

	Three month period ended June 30		Six month period ended June 30	
Expressed in thousands of dollars	2013	2012	2013	2012
(Decrease) increase in bank indebtedness	(11,342)	1,788	(4,861)	(3,903)
Increase in debt due within one year	280	1,751	779	17,502
Decrease in long-term debt	(2,914)	(3,675)	(5,349)	(5,799)
(Decrease) increase in long-term liabilities and provisions	(78)	10	(119)	158
Increase in borrowings	268	820	586	1,002
Cash provided by financing activities	(13,786)	694	(8,964)	8,960

On December 21, 2012, the Corporation amended its operating credit agreement with its existing lenders. Under the terms of the amended agreement, the maximum amount available under the operating credit facility was decreased to a Canadian dollar limit of \$115.0 million (down from \$125.0 million) plus a US dollar limit of \$35.0 million (down from US \$50.0 million), with a maturity date of December 21, 2014. The Bank Facility Agreement also includes a Cdn\$50 million uncommitted accordion provision which will provide Magellan with the option to increase the size of the operating credit facility to \$200 million. The facility is extendible for unlimited future one year renewal periods, subject to mutual consent of the syndicate of lenders and the Corporation. The operating credit facility continues to be fully guaranteed until December 21, 2014 by the Chairman of the Board of the Corporation in consideration of the continued payment by the Corporation of an annual fee, payable monthly, equal to 0.50% (down from 0.63%) of the loan amount.

On December 21, 2012, the Corporation also extended the 7.5% loan payable (“Original Loan”) to Edco Capital Corporation (“Edco”), a corporation controlled by the Chairman of the Board of the Corporation to January 1, 2015 in consideration of the payment of a fee to Edco equal to 0.75% of the principal amount outstanding at the time of extension. The Corporation has the right to repay the Original Loan at any time without penalty.

The terms of the amended operating credit agreement continue to permit the Corporation to repay, in whole or in part, the Original Loan from Edco provided there is no current default or event of default under the operating credit facility and after the repayment of the loan the Corporation has at least \$25.0 million in availability under the operating credit facility.

# Magellan Aerospace Corporation – Management’s Discussion & Analysis

## June 30, 2013

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### Outstanding Share Information

The authorized capital of the Corporation consists of an unlimited number of Preference Shares, issuable in series, and an unlimited number of common shares. As at May 8, 2013, 58,209,001 common shares were outstanding.

## 6. Financial Instruments

A summary of Magellan’s financial instruments

### Derivative Contracts

The Corporation operates internationally, which gives rise to a risk that its income, cash flows and shareholders’ equity may be adversely impacted by fluctuations in foreign exchange rates. Currency risk arises because the amount of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rates and because the non-Canadian dollar denominated financial statements of the Corporation’s subsidiaries may vary on consolidation into the reporting currency of Canadian dollars.

The Corporation uses derivative financial instruments to help manage foreign exchange risk with the objective of reducing transaction exposures and the resulting volatility of the Corporation’s earnings. The Corporation does not trade in derivatives for speculative purposes. Under these contracts the Corporation is obligated to purchase specified amounts at predetermined dates and exchange rates. These contracts are matched with anticipated cash flows in US dollars.

The counterparties to the foreign currency contracts are all major financial institutions with high credit ratings. As at June 30, 2013 the Corporation had foreign exchange contracts outstanding as follows:

Foreign exchange forward contracts	Amount	Rate
Maturity – less than 1 year – US Dollar	18,750	1.0150
Maturity – less than 1 year – US Dollar	7,500	1.0425

The fair values of the Corporation’s foreign exchange forward contracts are based on the current market values of similar contracts with the same remaining duration as if the contract had been entered into on June 30, 2013.

The mark-to-market on these financial instruments as at June 30, 2013 was an unrecognized loss of \$0.8 million which has been recorded in other expenses in the period.

### Off Balance Sheet Arrangements

The Corporation does not have any off-balance sheet arrangements that have or reasonably are likely to have a material effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. As a result, the Corporation is not exposed materially to any financing, liquidity, market or credit risk that could arise if it had engaged in these arrangements.

## 7. Related Party Transactions

A summary of Magellan’s transactions with related parties

During the three month period ended June 30, 2013, the Corporation paid guarantee fees in the amount of \$0.2 million to the Chairman of the Board of the Corporation. During the three month period ended June 30, 2013, the Corporation incurred interest of \$0.5 million in relation to the Original Loan due to Edco, a corporation which is controlled by the Chairman of the Board of the Corporation which is due on January 1, 2015. At June 30, 2013, the Corporation owed Edco interest of \$0.2 million.

## 8. Risk Factors

A summary of risks and uncertainties facing Magellan

The Corporation manages a number of risks in each of its businesses in order to achieve an acceptable level of risk without hindering the ability to maximize returns. Management has procedures to help identify and manage significant operational and financial risks.

For more information in relation to the risks inherent in Magellan’s business, reference is made to the information under “Risk Factors” in the Corporation’s Management’s Discussion and Analysis for the year ended December 31, 2012 and to



## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

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the information under “Risks Inherent in Magellan’s Business” in the Corporation’s Annual Information Form for the year ended December 31, 2012, which have been filed with SEDAR at [www.sedar.com](http://www.sedar.com).

## 9. Changes in Accounting Policies

A description of accounting standards adopted in the current year

The Corporation has adopted the new and amended IFRS pronouncements listed below as at January 1, 2013, in accordance with the transitional provisions outlined in the respective standards.

### *Consolidated Financial Statements*

IFRS 10, *Consolidated Financial Statements* (“IFRS 10”) replaced portions of IAS 27, *Consolidated and Separate Financial Statements*, that addressed consolidation, and superseded SIC-12, *Consolidation – Special Purpose Entities* (“SPE”), in its entirety. IFRS 10 provides a single model to be applied in the analysis of control of all investees, including entities that currently are SPEs in the scope of SIC-12. An investor must possess the following three elements to conclude if it controls an investee: power over the investee’s financial and operating decisions, exposure or rights to variable returns from involvement with the investee, and the ability to use power over the investee and its exposure or rights to variable returns.

The adoption of IFRS 10 had no impact on the consolidated interim financial statements for the period or prior periods presented as the adoption did not result in a change in the consolidation status of any of the Corporation’s subsidiaries or investees or the identification of any subsidiaries.

### *Joint Arrangements*

IFRS 11, *Joint Arrangements* (“IFRS 11”) supersedes IAS 31, *Interest in Joint Ventures* and SIC-13, *Jointly Controlled Entities – Non-Monetary Contributions*. Through an assessment of the rights and obligations in an arrangement, IFRS 11 establishes principles to determine the type of joint arrangement, which are classified as either joint operations or joint ventures, and provides guidance for financial reporting activities required by the entities that have an interest in arrangements that are controlled jointly.

In a joint operation, the parties to the joint arrangement have rights to the assets and obligations for the liabilities of the arrangement, and recognize their share of the assets, liabilities, revenues and expenses in accordance with applicable IFRS. In a joint venture, the parties to the arrangement have rights to the net assets of the arrangement and account for their interest using the equity method of accounting under IAS 28, *Investments in Associates and Joint Ventures* (“IAS 28”). IAS 28 prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The Corporation has concluded that its joint arrangement is a joint venture under IFRS 11 and, accordingly, has recorded its investment using the equity method of accounting whereas prior to adoption of IFRS 11, the proportionate consolidation method was used. The Corporation has applied the new policy retrospectively in accordance with the transitional provisions of IFRS 11 and recognized the deemed cost of its investments in joint ventures at January 1, 2012, as the net of the carrying amounts of the assets and liabilities previously proportionately consolidated by the Corporation. Under the equity method, the Corporation’s share of individual assets and liabilities are replaced with a net investment in joint ventures amount in the consolidated balance sheet and individual revenues and expenses are replaced with earnings from investment in joint ventures amount in the consolidated statement of income.

The Corporation has restated its consolidated interim financial statements for the comparative period to reflect the change in method of accounting for the joint venture. The Corporation’s consolidated revenues and expenses are reduced and the geographic information no longer includes the financial information of the joint venture. There is no impact on net earnings or earnings per share and the disclosure requirements have been incorporated into the Corporation’s condensed consolidated interim financial statements.

### *Disclosure of Interests in Other Entities*

IFRS 12, *Disclosure of Interests in Other Entities* (“IFRS 12”), contains disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity’s interests in other entities. The requirements of IFRS 12 relate to disclosures only and are applicable for the first annual period after adoption, and, accordingly, the additional disclosures about interests in other entities will be included in the annual consolidated financial statements for the year ended December 31, 2013.

## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

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The Corporation’s subsidiaries are all wholly owned and as such the determination of whether to consolidate these entities or the identification of any subsidiaries did not involve any significant judgments or assumptions. There are no significant restrictions on the ability of the Corporation to access or use the assets, and settle the liabilities of the Corporation and its subsidiaries except for customary limitations in the Corporation’s credit facility.

#### *Fair Value Measurement*

IFRS 13, *Fair Value Measurement* (“IFRS 13”) replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements.

The adoption of IFRS 13 did not have an effect on the determination of fair values and the required disclosures in the consolidated interim financial statements for the current period. The annual disclosure requirements will be incorporated in the annual consolidated financial statements for the year ended December 31, 2013.

#### *Presentation of Financial Statements*

IAS 1, *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income* (“IAS 1”), requires that a Corporation present separately the items of other comprehensive income (“OCI”) that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss.

The Corporation has amended its consolidated interim statements of comprehensive income for all periods presented in these consolidated interim financial statements to reflect the presentation changes required under the amended IAS 1. As these changes are reclassifications within the statement of comprehensive income, there is no net impact on comprehensive income.

#### *Employee Benefits*

IAS 19 *Employee Benefits* (“IAS 19”) was amended to eliminate the ‘corridor approach’ previously permitted and accelerate the recognition of past service costs. As part of its transition to IFRS, the Corporation elected to present remeasurements in OCI. The Corporation replaced interest costs on the defined benefit obligation and the expected return on plan assets with a net interest cost based on the net defined benefit asset or liability measured by applying the same discount rate used to measure the defined benefit obligation at the beginning of the annual period. Interest expense or interest income on net post-employment benefit liabilities and assets continue to be recognized in net income. IAS 19 requires termination benefits to be recognized at the earlier of when the entity can no longer withdraw an offer of termination benefits or recognizes any restructuring costs.

The amended version of IAS 19 was adopted with retrospective application and, accordingly, the comparative periods presented have been adjusted to reflect the reversal of any unamortized past service costs and the application of one discount rate to the net defined benefit asset or liability to determine the interest element of the defined benefit cost. The retrospective application of this amendment increased employee benefits expense by \$0.4 million and \$0.8 million, respectively for the three and six month period ended June 30, 2012. Net income for the three and six month period ended June 30, 2012 decreased by \$0.3 million and \$0.6 million, net of income taxes of \$0.1 million and \$0.2 million respectively. Basic net income per share decreased by \$0.01 for the six month period ended June 30, 2012.

## **10. Future Changes in Accounting Policies**

A description of new accounting standards and interpretations not yet adopted

A number of new standards, and amendments to standards and interpretations, are not yet effective for the interim period ended June 30, 2013, and have not been applied in preparing these condensed consolidated interim financial statements. The following standards and interpretations have been issued by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committees with effective dates relating to the annual accounting periods starting on or after the effective dates as follows:

#### *Financial Instruments – Recognition and Measurement*

In October 2010, the IASB published amendments to IFRS 9, *Financial Instruments* (“IFRS 9”) which provides added guidance on the classification and measurement of financial liabilities. IFRS 9 is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. The Corporation intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2015. The extent of the impact of adoption of IFRS 9 has not yet been determined.

# Magellan Aerospace Corporation – Management’s Discussion & Analysis

## June 30, 2013

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### *Financial Assets and Liabilities*

In December 2011, the IASB published amendments to IAS 32, *Financial Instruments: Presentation* (“IAS 32”) and issued new disclosure requirements in IFRS 7. The effective date for the amendments to IAS 32 is annual periods beginning on or after January 1, 2014 with retrospective application.

The amendments to IAS 32 clarify when an entity has a legally enforceable right to off-set as well as clarify, when a settlement mechanism provides for net settlement, or gross settlement that is equivalent to net settlement. The Corporation intends to adopt the amendments to IAS 32 in its consolidated financial statements for the annual period beginning January 1, 2014. The extent of the impact of adoption of the amendments to IAS 32 has not yet been determined.

## **11. Critical Accounting Estimates**

A description of accounting estimates that are critical to determining Magellan’s financial results

In the 2012 annual audited consolidated financial statements and management’s discussion and analysis, the Corporation identified the accounting policies and estimates that are critical to the understanding of the business and results of operations. Please refer to note 2 to the audited consolidated financial statements for the year ended December 31, 2012 for a discussion regarding the critical accounting estimates.

## **12. Controls and Procedures**

A description of Magellan’s disclosure controls and internal controls over financial reporting

Based on the current Canadian Securities Administrators (the “CSA”) rules under National Instrument 52-109 Certification of Disclosure in Issuers’ Annual and Interim Filings, the Chief Executive Officer and Chief Financial Officer (or individuals performing similar functions as a chief executive officer or chief financial officer) are required to certify as at June 30, 2013 that they are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting.

Management does not expect disclosure controls and procedures and internal control over financial reporting to prevent all errors, misstatements or fraud. In addition, internal control over financial reporting that management has designed and established may be circumvented and rendered ineffective as a result of unauthorized acts of individuals through collusion or management override. A system of control, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that control objectives are met. Due to the inherent limitations in a system of control, there is no absolute assurance that all controls issues, which may result in errors, misstatements, or fraud, can be prevented or detected. The inherent limitations include, amongst other things: (i) management’s assumptions and judgements could ultimately prove to be incorrect under varying conditions and circumstances; (ii) the impact of isolated errors; (iii) assumptions about the likelihood of future events.

No changes were made in the Corporation’s internal control over financial reporting during the Corporation’s most recent interim period, that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

## **13. Outlook**

The outlook for Magellan’s business in 2013

During the recent Paris Air Show held in June, both Boeing and Airbus confirmed the continuing strength of the commercial aerospace market. They released their twenty-year aircraft market forecasts which predict approximately 34,000 new airplanes to be delivered between 2012 and 2031. Of these, 68% are narrow-bodies, and 24% twin aisle aircraft. Boeing suggests that 41% will be replacement aircraft with 59% growth aircraft. Supporting the strength in narrow-bodies, Boeing increased its 737 build rate to 38 per month (from 35 per month) as planned in the second quarter of 2013 and Airbus is sustaining its A320 rate at 42 aircraft per month. With an approved battery resolution in place, Boeing continues a 7 aircraft per month 787 build rate and maintains it will reach 10 per month by the end of 2013. Airbus is planning to increase A330 production rates to 11 per month (from 9 per month) in the second quarter of 2014 with the A380 production rates returning to 2.7 per month. The A350XWB is currently at 0.8 per month with a plan to reach 13 per month in 2017 when in full production.

Global competition within the commercial aircraft market is causing major OEM’s to apply pressure on the supply chain to cut costs. This message is reverberating down from air-frame manufacturers, through major aerostructures suppliers to engine manufacturers. Magellan anticipates increased leverage being applied by OEM’s as they take a “One Company”

## Magellan Aerospace Corporation – Management’s Discussion & Analysis

### June 30, 2013

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consolidated approach to their supply chain partners. This consolidated company view, combined with cost pressures in the market place, continues to present challenges to the supply chain.

The business jet market is currently experiencing a modest growth in the large cabin segment while the small and medium cabin segments have experienced declines in both 2012 and 2013. The current aggregate forecast from various sources indicates that even with flat economic indicators in 2013, the market could see 10% growth in 2014, which would be the first overall growth in this sector since 2008.

A decade of growth in defence spending combined with an unprecedented positive trend in the commercial aerospace market resulted in 2012 being a strong year for top aerospace and defence OEM’s. Now as defence budgets are being reduced, industry results may be more challenging going forward. In Europe, industry experts say that consolidation will be necessary to eliminate the inevitable higher costs that the industry historically incurs as a result of underutilized capacity. However, given the positive financial performance to date, there doesn’t seem to be any urgency yet to make such moves.

On the defence side, the industry is facing a multi-year downturn in United States defence spending, the extent of which has yet to be quantified. Defence OEM’s have already cut production rates on certain programs for the fiscal year 2013. If Congress does not change the existing laws, sequestration is expected to precipitate an across the board cut of 15% to 20% in fiscal year 2014. If a cap reduction is agreed then certain programs may be affected disproportionately. The industry is looking to see if Congress will pass a deficit reduction package prior to the beginning of fiscal year 2014, which would be in the October 2013 timeframe.

The Corporation remains confident that the aircraft program and content balance it has in place will help to insulate Magellan from the continuing downturn in defence spending.

Magellan anticipates positive results going forward from their ongoing discussions with key customers in the space and communications segment of its business and its current activities in its proprietary products division, specifically in the future opportunities being developed in the Wire Strike market.

Additional information relating to Magellan Aerospace Corporation, including the Corporation’s annual information form, can be found on the SEDAR web site at [www.sedar.com](http://www.sedar.com).