



MAGELLAN
A E R O S P A C E

QUARTERLY REPORT

JUNE 30, 2016



This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Magellan Aerospace Corporation ("Magellan" or the "Corporation") should be read in conjunction with the unaudited condensed consolidated interim financial statements and the notes thereto for the three and six month periods ended June 30, 2016, and the audited annual consolidated financial statements for the year ended December 31, 2015 (available on SEDAR at www.sedar.com). Unless otherwise noted, all financial information has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), specifically International Accounting Standard ("IAS") 34, *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"), which is within the framework of International Financial Reporting Standards ("IFRS"). 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, 2016 relative to the three month period ended June 30, 2015. The information contained in this report is as at August 10, 2016. 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 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 a generally accepted earnings measure 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.

Business Update

On May 10, 2016, Magellan announced an agreement between Magellan and GKN Aerospace ("GKN Aerospace") for a contract extension to deliver precision aluminium and titanium components and assemblies to GKN Aerospace's Filton facility where complex wing structures are manufactured and assembled for the A320, A330 and A380 aircraft programs. This contract extension is projected to generate revenues in excess of CDN \$130 million through to December 2020 and the components and assemblies will be supplied from Magellan facilities located in the United Kingdom and Poland and its joint

ventures in India. Magellan was also awarded a new contract to supply A350 outboard flap precision machine details and assemblies. This new contract is projected to generate revenues of CDN \$36 million to December 2020.

On May 26, 2016, the Corporation announced the signing of a Memorandum of Understanding with ATLAS ELEKTRONIK Canada to collaborate on the development of rocket motor sections for the SeaSpider[®] Anti-Torpedo-Torpedo. SeaSpider[®] will combine the best technology and experiences of two worlds – the experience of ATLAS ELEKTRONIK in naval systems like the SeaHake[®] mod4 heavyweight torpedo and the leading rocket technology of Magellan Aerospace as chosen by NASA.

Magellan attended the Farnborough International Air Show which was held from July 11th through July 17th 2016 in Farnborough, United Kingdom. The Corporation's goal at this show was to further its strategy of aligning with customers' strategies for future growth.

For additional information, please refer to the "Management's Discussion and Analysis" section of the Corporation's 2015 Annual Report available on www.sedar.com.

2. Results of Operations

A discussion of Magellan's operating results for second quarter ended June 30, 2016

The Corporation operates substantially all of its activities in one reportable segment, Aerospace, which includes the design, development, manufacture, repair and overhaul and sale of systems and components for defence and civil aviation. The Corporation continues to provide services to the Power Generation segment, however the Corporation has removed the disclosure of this segment as the activity in relation to these services was not material in the current quarter and, at present, it is not expected to be material in future periods.

The Corporation reported higher revenue in the second quarter of 2016 of \$252.7 million when compared to the second quarter of 2015 of \$234.4 million. Gross profit and net income for the second quarter of 2016 were \$45.9 million and \$22.3 million, respectively, an increase from the gross profit of \$40.8 million and net income of \$16.5 million for the second quarter of 2015.

Consolidated Revenue

| Expressed in thousands of dollars | Three month period ended June 30 | | | Six month period ended June 30 | | |
|-----------------------------------|-------------------------------------|---------|--------|-----------------------------------|---------|--------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Canada | 81,515 | 78,295 | 4.1% | 173,857 | 156,846 | 10.8% |
| United States | 89,176 | 84,726 | 5.3% | 177,533 | 167,432 | 6.0% |
| Europe | 81,980 | 71,418 | 14.8% | 167,339 | 138,414 | 20.9% |
| Total revenues | 252,671 | 234,439 | 7.8% | 518,729 | 462,692 | 12.1% |

Consolidated revenues for the three months ended June 30, 2016 were \$252.7 million, \$18.3 million or 7.8% higher than \$234.4 million recorded for the same period in 2015. Revenues in Canada increased 4.1% in the second quarter of 2016 compared to the same period in 2015, primarily due to volume increase in aeroengine and aerostructure products, and the strengthening, on a year over year basis, of the United States dollar against the Canadian dollar, partially offset by lower revenues related to space and specialty products. On a currency neutral basis, Canadian revenues in the second quarter of 2016 slightly increased by 1.1% over the same period of 2015.

Revenues in United States increased 5.3% in the second quarter of 2016 in comparison to the second quarter of 2015 when measured in Canadian dollars mainly due to favourable foreign exchange impact. On a currency neutral basis, revenues in the United States was relatively flat on a year over year basis.

European revenues increased \$10.6 million or 14.8% to \$82.0 million in the second quarter of 2016 compared to \$71.4 million during the same period in 2015, primarily due to higher revenues as a result of increased production build rates and the acquisition of Euravia Engineering & Supply Co. Limited ("Euravia"), by the Corporation in mid-2015. On a constant currency basis, revenues in the second quarter of 2016 in Europe increased by 17.1% compared to the same period in 2015.

Gross Profit

| Expressed in thousands of dollars | Three month period ended June 30 | | | Six month period ended June 30 | | |
|-----------------------------------|----------------------------------|--------|--------|--------------------------------|--------|--------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Gross profit | 45,946 | 40,832 | 12.5% | 94,471 | 80,027 | 18.0% |
| Percentage of revenues | 18.2% | 17.4% | | 18.2% | 17.3% | |

Gross profit increased \$5.1 million to \$45.9 million for the second quarter of 2016 compared to \$40.8 million for the second quarter of 2015 and gross profit as a percentage of revenues increased to 18.2% for the second quarter of 2016 compared to 17.4% for the same period in 2015. Increase in gross profit was primarily driven by operations in Canada and United States due to the strengthening year over year of the United States dollar against the Canadian dollar, favourable product mix and production efficiencies. The acquisitions of Euravia and Ripak also contributed to the increased gross profit in the second quarter of 2016 when compared to the same period in 2015. However, the weakening British pound in comparison to the Canadian dollar slightly decreased the gross profit for the period.

Administrative and General Expenses

| Expressed in thousands of dollars | Three month period ended June 30 | | | Six month period ended June 30 | | |
|-------------------------------------|----------------------------------|--------|--------|--------------------------------|--------|--------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Administrative and general expenses | 13,583 | 14,603 | (7.0%) | 28,782 | 27,718 | 3.8% |
| Percentage of revenues | 5.4% | 6.2% | | 5.5% | 6.0% | |

Administrative and general expenses as a percentage of revenues of 5.4% for the second quarter of 2016 were 0.8% lower than that in the corresponding period of 2015. Administrative and general expenses decreased \$1.0 million or 7.0% to \$13.6 million in the second quarter of 2016 compared to \$14.6 million in the second quarter of 2015 mainly due to \$1.3 million legal settlement recovery, net of tax, relating to a rental agreement. In addition, there was \$0.5 million acquisition related transaction costs recorded in the three month period ended June 30, 2015. The overall decrease was partially offset by unfavourable foreign exchange and general increases in various categories of administrative and general expenses.

Other

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|---|----------------------------------|-------|--------------------------------|------|
| | 2016 | 2015 | 2016 | 2015 |
| Foreign exchange (gain) loss | (962) | 2,251 | (849) | 72 |
| Business closure costs | 2,208 | – | 2,208 | – |
| Loss on disposal of property, plant and equipment | 61 | 375 | 185 | 476 |
| Total other | 1,307 | 2,626 | 1,544 | 548 |

Other expense of \$1.3 million for the second quarter of 2016 decreased \$1.4 million or 50.2% compared to \$2.6 million for the second quarter of 2015. The Corporation recorded a foreign exchange gain of \$1.0 million in the second quarter of 2016, in contrast to a \$2.3 million foreign exchange loss in the same period of 2015. The movements in balances denominated in the foreign currencies and the fluctuations of the foreign exchange rates impact the net foreign exchange loss or gain recorded in a quarter. During the second quarter of 2016, the Corporation also recorded a \$2.2 million charge related to closure of a small operating facility in the United States.

Interest Expense

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|---|----------------------------------|-------|--------------------------------|-------|
| | 2016 | 2015 | 2016 | 2015 |
| Interest on bank indebtedness and long-term debt | 890 | 1,002 | 2,171 | 1,973 |
| Accretion charge on borrowings and long-term debt | 260 | 268 | 467 | 480 |
| Discount on sale of accounts receivable | 316 | 225 | 647 | 432 |
| Total interest expense | 1,466 | 1,495 | 3,285 | 2,885 |

Total interest expense of \$1.5 million in the second quarter of 2016 was consistent with that in the second quarter of 2015. On a year over year basis, interest on bank indebtedness and long-term debt of \$0.9 million decreased \$0.1 million or 11.1% mainly as a result of lower principal amounts outstanding on bank indebtedness and long term debt during the second quarter of 2016 than those in the second quarter of 2015. Discount on sale of accounts receivable of \$0.3 million increased

\$0.1 million due to a larger volume of receivables transferred under the securitization program for the second of quarter of 2016 compared to the same period in the prior year.

Provision for Income Taxes

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|-----------------------------------|----------------------------------|-------|--------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Current income tax expense | 4,159 | 2,792 | 7,747 | 4,282 |
| Deferred income tax expense | 3,110 | 2,849 | 7,364 | 8,905 |
| Income tax expense | 7,269 | 5,641 | 15,111 | 13,187 |
| Effective tax rate | 24.6% | 25.5% | 24.8% | 27.0% |

Income tax expense for the three months ended June 30, 2016 was \$7.3 million, representing an effective income tax rate of 24.6% compared to 25.5% for the same period of 2015. The decrease in effective tax rate year over year was primarily due to an adjustment in corporation taxation rates in the income tax jurisdictions in which the Corporation operates. The increase in current income taxes expense during the current quarter was mainly due to full utilization of the net operating loss carry-forwards and certain tax credits in the United States than in the second quarter of 2015.

3. Selected Quarterly Financial Information

A summary view of Magellan's quarterly financial performance

| Expressed in millions of dollars, except per share amounts | 2016 | | 2015 | | | 2014 | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
| | Jun 30 | Mar 31 | Dec 31 | Sep 30 | Jun 30 | Mar 31 | Dec 31 | Sep 30 |
| Revenues | 252.7 | 266.1 | 252.6 | 236.2 | 234.4 | 228.4 | 208.9 | 202.5 |
| Income before taxes | 29.6 | 31.3 | 27.1 | 24.8 | 21.8 | 26.8 | 23.9 | 17.7 |
| Net Income | 22.3 | 23.4 | 25.5 | 18.5 | 16.2 | 19.2 | 17.9 | 13.0 |
| Net Income per share | | | | | | | | |
| Basic and diluted | 0.38 | 0.40 | 0.44 | 0.32 | 0.28 | 0.33 | 0.31 | 0.22 |
| EBITDA ¹ | 44.7 | 45.8 | 43.1 | 37.8 | 33.5 | 37.4 | 34.7 | 28.3 |

¹ EBITDA is not an IFRS financial measure. Please see the "Reconciliation of Net Income to EBITDA" section for more information.

The Corporation reported its highest quarterly revenues in its history in the first quarter of 2016. The Corporation has been reporting a steady uptrend of revenue over the periods presented in the table above, partially due to favourable foreign exchange impact driven by a relatively stronger United States dollar and British pound against the Canadian dollar. The average exchange rate of United States dollar relative to the Canadian dollar fluctuated between a high of 1.3748 and a low of 1.0893. The average exchange rate of British pound relative to the Canadian dollar fluctuated between a high of 2.0280 and a low of 1.7974.

Revenue for the second quarter of 2016 of \$252.7 million was \$13.4 million or 5% lower than that in the first quarter of 2016 mainly due to unfavourable foreign exchange impact. The average exchange rate of United States dollar against the Canadian dollar moved from 1.3748 during the first quarter of 2016 to 1.2885 during the current quarter. The average exchange rate of British pound relative to the Canadian dollar moved from 1.9674 during the first quarter of 2016 to 1.8487 during the second quarter of 2016. Had the foreign exchange rates remained at levels experienced in the first quarter of 2016, reported revenues in the second quarter of 2016 would have increased by \$14.8 million. Revenue for the second quarter of 2016 of \$252.7 million was \$18.3 million or 7.8% higher than \$234.4 million recorded in the second quarter of 2015. On a constant currency basis, revenue for the second quarter of 2016 would have been lower by \$4.8 million.

Net income for the first quarter of 2016 and fourth quarter of 2015 of \$23.4 million and \$25.5 million, respectively, was higher than all other quarterly net income shown in the table above. As discussed above, net income reported in the quarterly information was also positively impacted by the favourable foreign exchange movements. During the first and second quarter of 2016, the Corporation recorded higher income taxes due to full utilization of the net operating loss carry-forwards and certain tax credits in the United States in the second quarter of 2015. In the second quarter of 2015, the Corporation recorded a loss on translation of its foreign currency liabilities within Canada and Europe. In the fourth quarter of 2014, the Corporation recognized previously unrecognized investment tax credits.

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 EBITDA (earnings before interest expense, income taxes and depreciation and amortization) in this quarterly statement. 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.

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|-----------------------------------|-------------------------------------|--------|-----------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | 22,321 | 16,467 | 45,749 | 35,689 |
| Interest | 1,466 | 1,495 | 3,285 | 2,885 |
| Taxes | 7,269 | 5,641 | 15,111 | 13,187 |
| Depreciation and amortization | 13,686 | 9,918 | 26,423 | 19,112 |
| EBITDA | 44,742 | 33,521 | 90,568 | 70,873 |

EBITDA increased \$11.2 million or 33.5% to \$44.7 million for the second quarter of 2016, compared to \$33.5 million in the second quarter of 2015 primarily as a result of higher net income and higher taxes and depreciation and amortization expenses.

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.

Cash Flow from Operations

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|---|-------------------------------------|---------|-----------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Decrease (increase) in accounts receivable | 293 | 2,728 | (18,143) | (23,931) |
| Increase in inventories | (7,798) | (942) | (10,117) | (7,759) |
| (Increase) decrease in prepaid expenses and other | (133) | (2,549) | 506 | (1,716) |
| (Decrease) increase in accounts payable, accrued liabilities and provisions | (7,089) | 8,168 | (491) | 14,153 |
| Changes in non-cash working capital balances | (14,727) | 7,405 | (28,245) | (19,253) |
| Cash provided by operating activities | 22,360 | 36,070 | 47,761 | 43,032 |

For the three months ended June 30, 2016, the Corporation generated \$22.4 million from operating activities, compared to \$36.1 million in the second quarter of 2015. The decrease in cash flow from operations was significantly impacted by the increased working capital investment in the second quarter of 2016, partially offset by higher net income and non-cash items, such as depreciation and amortization expenses, and impairment of property, plant and equipment.

Investing Activities

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|--|-------------------------------------|----------|-----------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Business combinations | – | (50,462) | – | (50,462) |
| Purchase of property, plant and equipment | (7,956) | (8,921) | (11,590) | (14,980) |
| Proceeds of disposals of property, plant and equipment | 4 | 107 | 163 | 299 |
| Increase in other assets | (2,410) | (921) | (7,055) | (3,533) |
| Change in restricted cash | 4,449 | – | 5,225 | – |
| Cash used in investing activities | (5,913) | (60,197) | (13,257) | (68,676) |

Cash used in investing activities for the second quarter of 2016 was \$5.9 million compared to \$60.2 million in the same quarter of 2015, a significant decrease of \$54.3 million primarily due to \$50.5 million invested in the acquisition of Euravia in May 2015, and a \$4.5 million change in restricted cash. The Corporation continues to invest in capital expenditures to enhance its manufacturing capabilities in various geographies and to support new customer programs. Total capital expenditures for the three month period ended June 30, 2016 were \$8.0 million, \$1.0 million lower than those invested in the same period of the prior year.

Financing Activities

| Expressed in thousands of dollars | Three month period ended June 30 | | Six month period ended June 30 | |
|--|-------------------------------------|---------|-----------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| (Decrease) increase in bank indebtedness | (18,509) | 39,748 | (29,213) | 41,115 |
| Increase in debt due within one year | 4,923 | 323 | 2,706 | 3,292 |
| Decrease in long-term debt | (1,143) | (2,961) | (2,251) | (3,955) |
| Increase in long-term debt | – | – | – | 276 |
| Increase in long-term liabilities and provisions | 461 | 28 | 208 | 768 |
| Increase in borrowings | 697 | 99 | 807 | 184 |
| Common share dividend | (3,347) | (3,201) | (6,694) | (6,403) |
| Cash (used in) provided by financing activities | (16,918) | 34,036 | (34,437) | 35,277 |

The Corporation has an operating credit facility, with a syndicate of banks, with a Canadian dollar limit of \$95,000, a US dollar limit of US\$35,000 and a British pound limit of £11,000. Under the terms of the credit agreement, the operating credit facility expires on September 30, 2018. Extensions of the facility are subject to mutual consent of the syndicate of lenders and the Corporation. The credit agreement also includes a Canadian \$50,000 uncommitted accordion provision which will provide the Corporation with the option to increase the size of the operating credit facility. The credit agreement was amended on December 4, 2015 to include a short term bridge credit facility that increased the operating credit facility by a US dollar limit US\$10,000, which expired on March 4, 2016.

The Corporation used \$17.0 million in financing activities in the second quarter of 2016 mainly due to the repayment of the bank indebtedness.

As at June 30, 2016 the Corporation has made contractual commitments to purchase \$18.5 million of capital assets.

Dividends

During the second quarter of 2016, the Corporation declared and paid quarterly cash dividends of \$0.0575 per common shares representing an aggregating dividend payment of \$3.3 million.

Subsequent to June 30, 2016 the Corporation announced that its Board of Directors had declared a quarterly cash dividend on its common shares of \$0.0575 per common share. The dividend will be payable on September 30, 2016 to shareholders of record at the close of business on September 9, 2016.

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 August 10, 2016, 58,209,001 common shares were outstanding and no preference 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 from time to time may use 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 United States dollars. The counterparties to the foreign currency contracts are all major financial institutions with high credit ratings. The Corporation had no material foreign exchange contracts outstanding as at June 30, 2016.

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

For the three and six month periods ended June 30, 2016, the Corporation had no material transactions with related parties as defined in IAS 24 - *Related Party Disclosures*.

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, 2015 and to the information under "Risks Inherent in Magellan's Business" in the Corporation's Annual Information Form for the year ended December 31, 2015, which have been filed with SEDAR at www.sedar.com.

9. Changes in Accounting Policies

A description of accounting standards adopted in the current year

The following new standards, and amendments to standards and interpretations, are effective for the first time for interim periods beginning on or after January 1, 2016 and have been applied in preparing the consolidated interim financial statements.

Property, Plant and Equipment and Intangibles Assets

In 2014, the IASB issued amendments to IAS 16, *Property, Plant and Equipment* ("IAS 16") and IAS 38, *Intangible Assets* ("IAS 38") to clarify acceptable methods of depreciation and amortization. The amended IAS 16 eliminates the use of a revenue-based depreciation method for items of property, plant and equipment. Similarly, amendments to IAS 38 eliminate the use of a revenue-based amortization model for intangible assets except in certain specific circumstances. As at January 1, 2016, the Corporation adopted the amendments and there was no material impact on the condensed consolidated interim financial statements.

Joint Arrangements

In 2014, the IASB issued amendments to IFRS 11, *Joint Arrangements* (“IFRS 11”) to address the accounting for acquisitions of interests in joint operations. The amendments address how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business. IFRS 11, as amended, now requires that such transactions shall be accounted for using the principles related to business combinations accounting as outlined in IFRS 3, *Business Combinations*. As at January 1, 2016, the Corporation adopted the amendments and there was no impact on the condensed consolidated interim financial statements.

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, 2016, and have not been applied in preparing these condensed consolidated interim financial statements. These changes are not yet adopted by the Corporation and could have an impact on future periods. These changes are described in detail in the Corporation’s 2015 audited annual consolidated financial statements.

- IFRS 15, *Revenue from Contracts with Customers*
- IFRS 9, *Financial Instruments*
- IFRS 16, *Leases*
- Amendments to IAS 12, *Recognition of Deferred Tax Assets for Unrealised Losses*
- Amendments to IAS 7, *Disclosure Initiative*
- Amendments to IFRS 2, *Classification and Measurement of Share-based Payment Transactions*

The Corporation is in the process of evaluating the impact of adopting these standards on the Corporation’s consolidated financial statements.

11. Critical Accounting Estimates

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

In the 2015 audited annual 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 1 to the audited consolidated financial statements for the year ended December 31, 2015 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, 2016 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 2016

The commercial aircraft market continues to be robust with single-aisle aircraft production ramp rates dominating discussions. Aircraft manufacturers are focused on executing schedules, on meeting cost challenges, and on ensuring the supply chain is sufficiently prepared to support them.

Airbus's A320 build rate increased from 44 aircraft per month in the first quarter of 2016 to 46 aircraft per month beginning in the second quarter of 2016. Airbus is planning to build 600 aircraft in 2017 at a rate of 50 aircraft per month. That rate is expected to grow to 55 aircraft per month in 2018 and 60 aircraft per month by the end of 2018. Boeing's 737 build rate is currently at 42 aircraft per month and is expected to grow to 47 aircraft per month during 2017 and 52 aircraft per month in 2018. Airbus is also ramping up its new A350XWB wide body production. It is expected that they will build 70 aircraft in 2016, 95 aircraft in 2018, and 116 aircraft in 2019. A380 production will peak at 26 aircraft in 2016 and then begin to decline as order backlogs diminish. Boeing's 787 build rate is now at 12 aircraft per month.

In the regional market this quarter, Embraer achieved first flight for its new E190-E2 aircraft and Bombardier handed over the first CS100 aircraft to Swiss Air. This 90 to 110 seat regional segment is currently the strongest in this market. The regional turboprop segment remains down.

Orders for small to medium business jets began to rebound in 2015 as continuing improvement in the United States economy unlocked latent demand. In the large business jet market, Bombardier was the first to react to a decline in demand by cutting their Global Series production rates from 80 aircraft annually down to 50 aircraft, and postponing entry into service of the new Global 7000 by two years. It is expected that Dassault and Gulfstream will follow suit with similar cuts. Overall, deliveries in this market fell by 8% in 2015, representing the largest dip over the last 10 years. Some suggest the reason for the dip is that wealthy owners of large-cabin jets in emerging markets such as Brazil, China and Russia, have been hit hard by the crash in oil and commodity prices coupled with the rising strength of the dollar. Others have speculated that traditional buyers of larger jets are holding out for a new developing class of mid-size jet that offers an inter-continental range with desired amenities.

Defence aerospace news has been widely populated with reports of international competitions for new equipment, weighing requirements/capabilities against affordability. Recently, Denmark announced that the fifth generation F-35A emerged as the winner against Eurofighter and Boeing's F/A-18F Super Hornet in their comprehensive fighter competition. In other examples, legacy platforms emerged as winners. This reinforces the importance of being strategically positioned on major competing platforms, as is the strategy of Magellan.

In 2016, the F-35 Joint Strike Fighter program plans to deliver 53 aircraft. By 2018 deliveries are expected to approach 100 aircraft and reach 145 aircraft by 2020. On May 2, 2016, F-35 Fighter pilots from Hill Air Force Base began flying routine four-ship combat training missions at the Utah Test and Training Range. This marked a key milestone in getting the USAF's newest fighter jet to reach initial operational capability (IOC) later this year. The first operational F-35 arrived at Hill AFB in September 2015. The base will be home to three operational F-35 fighter squadrons with a total of 78 aircraft by the end of 2019. With Denmark's recent F-35 announcement, Canada is the only remaining partnering country on the F-35 Joint Strike Fighter program which has not committed to purchase F-35. Magellan is a member of the Canadian JSF Industrial Group (CJIG) and has been supporting efforts to promote the current and future benefits of Canada's participation on the F-35 Joint Strike Fighter program.

Finally, OEM's are attempting to find reason for optimism in the commercial helicopter market which has softened much more than most anticipated. A significant contributor to this softening has been the slump in oil and gas. It is believed that this market will continue to be slow through 2017 before any true signs of rebound appear. Activity remains steady if not slightly improved for defence helicopters, as international budgets are prioritized and as pressure comes on NATO countries to pull their weight and commit to spending 2% of GDP towards defence.

MAGELLAN AEROSPACE CORPORATION
CONSOLIDATED INTERIM STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

| (unaudited) (expressed in thousands of Canadian dollars, except per share amounts) | Notes | Three month period ended June 30 | | Six month period ended June 30 | |
|--|-------|-------------------------------------|---------|-----------------------------------|---------|
| | | 2016 | 2015 | 2016 | 2015 |
| Revenues | 8 | 252,671 | 234,439 | 518,729 | 462,692 |
| Cost of revenues | | 206,725 | 193,607 | 424,258 | 382,665 |
| Gross profit | | 45,946 | 40,832 | 94,471 | 80,027 |
| Administrative and general expenses | | 13,583 | 14,603 | 28,782 | 27,718 |
| Other | 9 | 1,307 | 2,626 | 1,544 | 548 |
| Income before interest and income taxes | | 31,056 | 23,603 | 64,145 | 51,761 |
| Interest | | 1,466 | 1,495 | 3,285 | 2,885 |
| Income before income taxes | | 29,590 | 22,108 | 60,860 | 48,876 |
| Income taxes | | | | | |
| Current | 10 | 4,159 | 2,792 | 7,747 | 4,282 |
| Deferred | 10 | 3,110 | 2,849 | 7,364 | 8,905 |
| | | 7,269 | 5,641 | 15,111 | 13,187 |
| Net income | | 22,321 | 16,467 | 45,749 | 35,689 |
| Other comprehensive income | | | | | |
| Other comprehensive (loss) income that may be reclassified to profit and loss in subsequent periods: | | | | | |
| Foreign currency translation (loss) gain | | (16,095) | 3,364 | (45,472) | 21,183 |
| Items not to be reclassified to profit and loss in subsequent periods: | | | | | |
| Actuarial (loss) gain on defined benefit pension plans, net of tax | 5 | (4,528) | 3,660 | (8,471) | 2,210 |
| Total comprehensive income (loss), net of tax | | 1,698 | 23,491 | (8,194) | 59,082 |
| Net income per share | | | | | |
| Basic and diluted | 6 | 0.38 | 0.28 | 0.79 | 0.61 |

See accompanying notes to condensed consolidated interim financial statements

MAGELLAN AEROSPACE CORPORATION
CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION

| (unaudited) (expressed in thousands of Canadian dollars) | Notes | June 30 2016 | December 31 2015 |
|---|-------|-----------------|---------------------|
| Current assets | | | |
| Cash | | 5,018 | 5,538 |
| Restricted cash | | 7,418 | 12,902 |
| Trade and other receivables | | 209,780 | 207,074 |
| Inventories | | 211,055 | 215,351 |
| Prepaid expenses and other | | 15,303 | 17,914 |
| | | 448,574 | 458,779 |
| Non-current assets | | | |
| Property, plant and equipment | | 372,777 | 405,526 |
| Investment properties | | 4,515 | 4,753 |
| Intangible assets | | 74,059 | 87,844 |
| Goodwill | | 34,382 | 39,439 |
| Other assets | | 28,000 | 23,642 |
| Deferred tax assets | | 28,499 | 30,070 |
| | | 542,232 | 591,274 |
| Total assets | | 990,806 | 1,050,053 |
| Current liabilities | | | |
| Accounts payable and accrued liabilities and provisions | 9 | 149,814 | 158,490 |
| Debt due within one year | | 55,768 | 55,255 |
| | | 205,582 | 213,745 |
| Non-current liabilities | | | |
| Bank indebtedness | 4 | 101,295 | 135,828 |
| Long-term debt | | 37,231 | 40,402 |
| Borrowings subject to specific conditions | | 20,404 | 19,751 |
| Other long-term liabilities and provisions | 5,9 | 31,876 | 26,047 |
| Deferred tax liabilities | | 31,961 | 36,935 |
| | | 222,767 | 258,963 |
| Equity | | | |
| Share capital | | 254,440 | 254,440 |
| Contributed surplus | | 2,044 | 2,044 |
| Other paid in capital | | 13,565 | 13,565 |
| Retained earnings | | 266,285 | 235,701 |
| Accumulated other comprehensive income | | 26,123 | 71,595 |
| | | 562,457 | 577,345 |
| Total liabilities and equity | | 990,806 | 1,050,053 |

See accompanying notes to condensed consolidated interim financial statements

MAGELLAN AEROSPACE CORPORATION
CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

| (unaudited) (expressed in thousands of Canadian dollars) | Share capital | Contributed surplus | Other paid in capital | Retained earnings | Foreign currency translation | Total equity |
|---|------------------|------------------------|-----------------------------|----------------------|------------------------------------|-----------------|
| December 31, 2015 | 254,440 | 2,044 | 13,565 | 235,701 | 71,595 | 577,345 |
| Net income for the period | - | - | - | 45,749 | - | 45,749 |
| Other comprehensive loss for the period | - | - | - | (8,471) | (45,472) | (53,943) |
| Common share dividend | - | - | - | (6,694) | - | (6,694) |
| June 30, 2016 | 254,440 | 2,044 | 13,565 | 266,285 | 26,123 | 562,457 |
| | | | | | | |
| December 31, 2014 | 254,440 | 2,044 | 13,565 | 166,398 | 23,149 | 459,596 |
| Net income for the period | - | - | - | 35,689 | - | 35,689 |
| Other comprehensive income for the period | - | - | - | 2,210 | 21,183 | 23,393 |
| Common share dividend | - | - | - | (6,403) | - | (6,403) |
| June 30, 2015 | 254,440 | 2,044 | 13,565 | 197,894 | 44,332 | 512,275 |

See accompanying notes to condensed consolidated interim financial statements

MAGELLAN AEROSPACE CORPORATION
CONSOLIDATED INTERIM STATEMENTS OF CASH FLOW

| (unaudited) (expressed in thousands of Canadian dollars) | Notes | Three month period ended June 30 | | Six month period ended June 30 | |
|--|-------|-------------------------------------|-----------------|-----------------------------------|-----------------|
| | | 2016 | 2015 | 2016 | 2015 |
| Cash flow from operating activities | | | | | |
| Net income | | 22,321 | 16,467 | 45,749 | 35,689 |
| Amortization/depreciation of intangible assets and property, plant and equipment | | 13,686 | 9,918 | 26,423 | 19,112 |
| Impairment of property, plant and equipment | 9 | 1,135 | – | 1,135 | – |
| Loss on disposal of property, plant and equipment | | 61 | 375 | 185 | 476 |
| Decrease in defined benefit plans | | (396) | (22) | (758) | (178) |
| Accretion | | 260 | 269 | 467 | 481 |
| Deferred taxes | | 136 | 1,698 | 3,115 | 6,604 |
| (Income) loss on investments in joint ventures | | (116) | (40) | (310) | 101 |
| Changes to non-cash working capital | | (14,727) | 7,405 | (28,245) | (19,253) |
| Net cash provided by operating activities | | 22,360 | 36,070 | 47,761 | 43,032 |
| Cash flow from investing activities | | | | | |
| Business combinations | | – | (50,462) | – | (50,462) |
| Purchase of property, plant and equipment | | (7,956) | (8,921) | (11,590) | (14,980) |
| Proceeds from disposal of property, plant and equipment | | 4 | 107 | 163 | 299 |
| Increase in other assets | | (2,410) | (921) | (7,055) | (3,533) |
| Change in restricted cash | | 4,449 | – | 5,225 | – |
| Net cash used in investing activities | | (5,913) | (60,197) | (13,257) | (68,676) |
| Cash flow from financing activities | | | | | |
| (Decrease) increase in bank indebtedness | 4 | (18,509) | 39,748 | (29,213) | 41,115 |
| Increase in debt due within one year | | 4,923 | 323 | 2,706 | 3,292 |
| Decrease in long-term debt | | (1,143) | (2,961) | (2,251) | (3,955) |
| Increase in long-term debt | | – | – | – | 276 |
| Increase in long-term liabilities and provisions | | 461 | 28 | 208 | 768 |
| Increase in borrowings | | 697 | 99 | 807 | 184 |
| Common share dividend | 6 | (3,347) | (3,201) | (6,694) | (6,403) |
| Net cash (used in) provided by financing activities | | (16,918) | 34,036 | (34,437) | 35,277 |
| (Decrease) increase in cash during the period | | (471) | 9,909 | 67 | 9,633 |
| Cash at beginning of the period | | 5,659 | 2,608 | 5,538 | 2,645 |
| Effect of exchange rate differences | | (170) | 148 | (587) | 387 |
| Cash at end of the period | | 5,018 | 12,665 | 5,018 | 12,665 |

See accompanying notes to condensed consolidated interim financial statements

MAGELLAN AEROSPACE CORPORATION

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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

NOTE 1. DESCRIPTION OF BUSINESS AND NATURE OF OPERATIONS

Magellan Aerospace Corporation (the "Corporation" or "Magellan") is a publicly listed company incorporated in Ontario, Canada under the Ontario Business Corporations Act and its shares are listed on the Toronto Stock Exchange. The registered and head office of the Corporation is located at 3160 Derry Road East, Mississauga, Ontario, Canada, L4T 1A9.

The Corporation is a diversified supplier of components to the aerospace industry and in certain circumstances for power generation projects. Through its wholly owned subsidiaries, Magellan engineers and manufactures aeroengine and aerostructure components for aerospace markets, including 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 through repair and overhaul services, and supplies in certain circumstances parts and equipment for power generation projects.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") and using the same accounting policies and methods as were used for the Corporation's consolidated financial statements and the notes thereto for the year ended December 31, 2015, except for the new accounting pronouncements which have been adopted as disclosed in Note 3.

These condensed consolidated interim financial statements do not include all the information required for full annual financial statements and should be read in conjunction with the Corporation's annual financial statements for the year ended December 31, 2015, which are available at www.sedar.com and on the Corporation's website at www.magellan.aero.

The timely preparation of the condensed consolidated interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the financial statements, and the reported amounts of revenue and expenses during the period. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the condensed consolidated interim financial statements.

These condensed consolidated interim financial statements were authorized for issuance by the Board of Directors of the Corporation on August 10, 2016.

NOTE 3. ADOPTION OF NEW AND AMENDED IFRS PRONOUNCEMENTS

The Corporation has adopted the new and amended International Financial Reporting Standards ("IFRS") pronouncements listed below as at January 1, 2016, in accordance with the transitional provisions outlined in the respective standards.

a) Property, Plant and Equipment and Intangibles Assets

In 2014, the IASB issued amendments to IAS 16, *Property, Plant and Equipment* ("IAS 16") and IAS 38, *Intangible Assets* ("IAS 38") to clarify acceptable methods of depreciation and amortization. The amended IAS 16 eliminates the use of a revenue-based depreciation method for items of property, plant and equipment. Similarly, amendments to IAS 38 eliminate the use of a revenue-based amortization model for intangible assets except in certain specific circumstances. As at January 1, 2016, the Corporation adopted the amendments and there was no material impact on the condensed consolidated interim financial statements.

b) Joint Arrangements

In 2014, the IASB issued amendments to IFRS 11, *Joint Arrangements* ("IFRS 11") to address the accounting for acquisitions of interests in joint operations. The amendments address how a joint operator should account for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business. IFRS 11, as amended, now requires that such transactions shall be accounted for using the principles related to business combinations accounting as outlined in IFRS 3, *Business Combinations*. As at January 1, 2016, the Corporation adopted the amendments and there was no impact on the condensed consolidated interim financial statements.

c) Recent accounting pronouncements not yet adopted

The IASB has issued new standards and amendments to existing standards. These changes are not yet adopted by the Corporation and could have an impact on future periods. These changes are described in detail in the Corporation's 2015 consolidated financial statements.

- IFRS 15, *Revenue from Contracts with Customers*
- IFRS 9, *Financial Instruments*
- IFRS 16, *Leases*

- Amendments to IAS 12, *Recognition of Deferred Tax Assets for Unrealised Losses*
- Amendments to IAS 7, *Disclosure Initiative*
- Amendments to IFRS 2, *Classification and Measurement of Share-based Payment Transactions*

The Corporation is in the process of evaluating the impact of adopting these standards on the Corporation's consolidated financial statements.

NOTE 4. BANK INDEBTEDNESS

On September 30, 2014, the Corporation amended its credit agreement with its existing lenders. The Corporation has an operating credit facility, with a syndicate of banks, with a Canadian dollar limit of \$95,000, a US dollar limit of US\$35,000 and a British Pound limit of £11,000 [\$159,126 at June 30, 2016]. Under the terms of the amended credit agreement, the operating credit facility expires on September 30, 2018. Extensions of the facility are subject to mutual consent of the syndicate of lenders and the Corporation. The credit agreement also includes a CDN\$50,000 uncommitted accordion provision which will provide the Corporation with the option to increase the size of the operating credit facility. The credit agreement was amended on December 4, 2015 to include a short term bridge credit facility that increased the operating credit facility by a US dollar limit US\$10,000 [\$13,840 at December 31, 2015]. The bridge credit facility expired on March 4, 2016. Bank indebtedness as at June 30, 2016 of \$101,295 [December 31, 2015 - \$135,828] bears interest at the bankers' acceptance or LIBOR rates plus 1.875% [2.54% at June 30, 2016 (December 31, 2015 - 2.53%)]. Included in the amount outstanding at June 30, 2016 is US\$23,052 and £8,342 [December 31, 2015 - US\$32,524 and £9,861]. At June 30, 2016, the Corporation had drawn \$105,133 under the operating credit facility, including letters of credit totalling \$3,838 such that \$53,993 was unused and available. A fixed and floating charge debenture on accounts receivable, inventories and property, plant and equipment is pledged as collateral for the operating credit facility.

NOTE 5. EMPLOYEE FUTURE BENEFITS

The Corporation has a number of defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to substantially all of its employees.

The employee benefit obligation reflected in the unaudited condensed consolidated interim financial statements is as follows:

| | June 30 2016 | December 31 2015 |
|-----------------------|-----------------|---------------------|
| Pension Benefit Plans | 21,424 | 10,854 |
| Other Benefit Plan | 1,192 | 1,263 |
| | 22,616 | 12,117 |

The discount rate assumption used in determining the obligation for pension and other benefit plans is selected based on a review of current market interest rates of high-quality, fixed rate debt securities adjusted to reflect the duration of the expected future cash outflows for pension benefit payments. As at June 30, 2016, the Corporation changed the assumed discount rate for the Canadian pension plans to 3.5% from the 3.9% and 4.0% rates used in calculating the pension obligation as at March 31, 2016 and December 31, 2015, respectively, as a result of reduction in the market interest rate of high-quality, fixed rate debt securities. In addition, the assumed discount rate for the U.S. pension plan decreased to 3.2% as at June 30, 2016 from 3.6% and 4.0% determined as at March 31, 2016 and December 31, 2015, respectively. The change in the discount rate assumptions and the difference between the actual and expected rate of return on the plan assets resulted in an actuarial loss of \$4,528 and \$8,471, net of taxes of \$1,627 and \$3,011, respectively, recorded in other comprehensive income in the three and six month periods ended June 30, 2016.

NOTE 6. SHARE CAPITAL

Net income per share

| | Three month period ended June 30 | | Six month period ended June 30 | |
|--|-------------------------------------|--------|-----------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | 22,321 | 16,467 | 45,749 | 35,689 |
| Weighted average number of shares | 58,209 | 58,209 | 58,209 | 58,209 |
| Basic and diluted net income per share | 0.38 | 0.28 | 0.79 | 0.61 |

Dividends

On March 31, 2016 and June 30, 2016, the Corporation paid quarterly dividends on 58,209,001 common shares of \$0.0575 per common share, amounting to \$6,694.

Subsequent to June 30, 2016, the Corporation declared dividends to holders of common shares in the amount of \$0.0575 per common share payable on September 30, 2016, for shareholders of record at the close of business on September 9, 2016.

NOTE 7. FINANCIAL INSTRUMENTS

Fair value hierarchy

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Fair values

The Corporation has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgement is required to develop these estimates. Accordingly, these estimated fair values are not necessarily indicative of the amounts the Corporation could realize in a current market exchange. The estimated fair value amounts can be materially affected by the use of different assumptions or methodologies. The methods and assumptions used to estimate the fair value of financial instruments are described as follows:

Cash, trade receivables, bank indebtedness and accounts payable and accrued liabilities

Due to the short period to maturity of these instruments, the carrying values as presented in the consolidated statement of financial positions are reasonable estimates of their fair values.

Foreign exchange contracts

The Corporation enters into foreign forward exchange contracts to mitigate future cash flow exposures in United States dollars and Euros. Under these contracts the Corporation is obliged to purchase specific amounts at predetermined dates and exchange rates. These contracts are matched with anticipated operational cash flows in United States dollars and Euros. The Company does not have any material forward foreign exchange contracts outstanding as at June 30, 2016.

Borrowings subject to specific conditions

As at June 30, 2016, the Corporation has recognized \$20,404 as the amount repayable to Canadian government agencies. The contributions are repayable as future royalty payments; a liability is recorded for the amounts received that will be repaid based on future estimated sales.

Contingent considerations

The contingent considerations recognized represent future amounts the Corporation may be required to pay in conjunction with various business combinations. The ultimate amount of future payments is based on specified future criteria, such as sales and earnings metrics. The Corporation estimates the fair value of the contingent consideration liabilities related to the achievement of these metrics by assigning an achievement probability to each potential milestone. During the second quarter of 2016, the Corporation has paid \$2,852 contingent consideration and as at June 30, 2016 recognized \$3,463 as a contingent liability.

Collateral

As at June 30, 2016, the carrying amount of the financial assets that the Corporation has pledged as collateral for its bank indebtedness and long-term debt facilities was \$194,294.

NOTE 8. SEGMENTED INFORMATION

Operating segments are defined as components of the Corporation for which separate financial information is available that is evaluated

regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Corporation is the President and Chief Executive Officer. The Corporation operates substantially all of its activities in one reportable segment, Aerospace, which include the design, development, manufacture, repair and overhaul, and sale of systems and components for defence and civil aviation.

The Corporation's primary sources of revenue are as follows:

| | Three month period ended June 30 | | Six month period ended June 30 | |
|------------------------|-------------------------------------|---------|-----------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Sale of goods | 211,169 | 201,587 | 432,059 | 398,534 |
| Construction contracts | 8,143 | 8,335 | 15,780 | 17,320 |
| Services | 33,359 | 24,517 | 70,890 | 46,838 |
| | 252,671 | 234,439 | 518,729 | 462,692 |

As at June 30, 2016, aggregate costs incurred under open construction contracts and recognized profits, net of recognized losses, amounted to \$361,482 [December 31, 2015 - \$351,672]. Advance payments received for construction contracts in progress at June 30, 2016 was \$1,426 [December 31, 2015 - \$3,439]. Retention in connection with construction contracts as at June 30, 2016 was \$292 [December 31, 2015 - \$313]. Advance payments and retentions are included in accounts payable, accrued liabilities and provisions.

Revenues from the Corporation's two largest customers accounted for 39.1% and 38.5% respectively of total sales for the three and six month periods ended June 30, 2016 [June 30, 2015 – two largest customers accounted for 37.1% and 37.4% respectively of total sales in the three and six month periods].

Geographic segments:

| | 2016 | | | | Three month period ended June 30 2015 | | | |
|-----------------------------|--------|---------------|--------|---------|--|---------------|--------|---------|
| | Canada | United States | Europe | Total | Canada | United States | Europe | Total |
| Revenue | 81,515 | 89,176 | 81,980 | 252,671 | 78,295 | 84,726 | 71,418 | 234,439 |
| Export revenue ¹ | 58,317 | 26,711 | 24,106 | 109,134 | 58,044 | 24,556 | 10,693 | 93,293 |

| | 2016 | | | | Six month period ended June 30 2015 | | | |
|-----------------------------|---------|---------------|---------|---------|--|---------------|---------|---------|
| | Canada | United States | Europe | Total | Canada | United States | Europe | Total |
| Revenue | 173,857 | 177,533 | 167,339 | 518,729 | 156,846 | 167,432 | 138,414 | 462,692 |
| Export revenue ¹ | 127,668 | 47,388 | 50,905 | 225,961 | 113,254 | 46,590 | 20,175 | 180,019 |

¹Export revenue is attributed to countries based on the location of the customers

| | June 30, 2016 | | | | December 31, 2015 | | | |
|---|---------------|---------------|---------|---------|-------------------|---------------|---------|---------|
| | Canada | United States | Europe | Total | Canada | United States | Europe | Total |
| Property, plant and equipment, intangible assets and goodwill | 167,082 | 183,031 | 131,105 | 481,218 | 169,853 | 205,375 | 157,581 | 532,809 |

NOTE 9. BUSINESS CLOSURE

During the second quarter of 2016, the Corporation determined to close an operating facility in the United States in order to lower operating costs, increase efficiencies and better align the Corporation's workforce with the needs of the business.

Costs associated with the closure are summarized below:

| | 2016 |
|----------------------------------|-------|
| Write-down of non-current assets | 1,135 |
| Severance and other | 1,073 |
| | 2,208 |

The write down of non-current assets consists of impairment charges to property, plant and equipment to bring them to the lower of carrying value and recoverable amount, which is based on their fair value less costs of disposal. The fair value less costs of disposal was determined by reference to quoted prices in active markets for identical assets and liabilities, and therefore, was categorized within Level 1 of the fair value hierarchy.

The severance and other costs related to severance and other termination benefits and are calculated based on long-standing benefit practices, local statutory requirement and, in certain cases, voluntary termination arrangements. Other costs consist



primarily of costs to exit facility leases. The severance and other liabilities have been recorded as current and long-term liabilities on the balance sheet.

NOTE 10. TAXATION

The Corporation's tax expense is calculated by using the rates applicable in each of the tax jurisdictions that the Corporation operates in, adjusted for the main permanent differences identified. The effective tax rate for the three and six month periods ended June 30, 2016 was 24.6% and 24.8% respectively [25.5% and 27.0% respectively for the three and six month periods ended June 30, 2015]. The difference between the effective tax rate and the standard tax rate is primarily attributable to the change in mix of income across the different jurisdictions in which the Corporation operates.

NOTE 11. MANAGEMENT OF CAPITAL

The Corporation's objective is to maintain a capital base sufficient to maintain investor, creditor and market confidence and to sustain future development of the business. Management defines capital as the Corporation's shareholders' equity and interest bearing debt, including the debt and equity components of the convertible debentures.

Total managed capital as at June 30, 2016 of \$756,751 is comprised of shareholders' equity of \$562,457 and interest-bearing debt of \$194,294.

The Corporation manages its capital structure and makes adjustments to it in light of economic conditions, the risk characteristics of the underlying assets and the Corporation's working capital requirements. In order to maintain or adjust its capital structure, the Corporation, upon approval from its Board of Directors, may issue or repay long-term debt, issue shares, repurchase shares through the normal course issuer bid, pay dividends or undertake other activities as deemed appropriate under the specific circumstances. The Board of Directors reviews and approves any material transactions out of the ordinary course of business, including proposals on acquisitions or other major investments or divestitures, as well as capital and operating budgets. There were no changes in the Corporation's approach to capital management during the period.

NOTE 12. CONTINGENT LIABILITIES AND COMMITMENTS

In the ordinary course of business activities, the Corporation may be contingently liable for litigation and claims with, among others, customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although, it is not possible to accurately estimate the extent of the potential costs and losses, if any, management believes, but can provide no assurance, that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Corporation.

At June 30, 2016 capital commitments in respect of purchase of property, plant and equipment totalled \$18,520, all of which had been ordered. There were no other material capital commitments at the end of the period.