

# **MAGELLAN**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2017**

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# Magellan Aerospace Corporation – Management’s Discussion & Analysis

## June 30, 2017

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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”) 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, 2017, and the audited annual consolidated financial statements for the year ended December 31, 2016 (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, 2017 relative to the three month period ended June 30, 2016. The information contained in this report is as at August 4, 2017. 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. 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.

Magellan operates substantially all of its activities in one reportable segment, Aerospace, which is viewed as one segment by the chief operating decision-makers for the purpose of resource allocations, assessing performance and strategic planning. The Aerospace segment includes the design, development, manufacture, repair and overhaul, and sale of systems and components for defence and civil aviation.

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## 2. Results of Operations

A discussion of Magellan’s operating results for second quarter ended June 30, 2017

The Corporation reported revenue in the second quarter of 2017 of \$253.5 million, a slight increase from the second quarter of 2016 of \$252.7 million. Gross profit and net income for the second quarter of 2017 were \$46.2 million and \$20.4 million, respectively, in comparison to gross profit of \$45.9 million and net income of \$22.3 million for the second quarter of 2016.

### Consolidated Revenue

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2017	2016	Change	2017	2016	Change
Canada	<b>82,256</b>	81,515	0.9%	<b>157,276</b>	173,857	(9.5%)
United States	<b>82,031</b>	89,176	(8.0%)	<b>162,056</b>	177,533	(8.7%)
Europe	<b>89,173</b>	81,980	8.8%	<b>181,338</b>	167,339	8.4%
Total revenues	<b>253,460</b>	252,671	0.3%	<b>500,670</b>	518,729	(3.5%)

Consolidated revenues for the three months ended June 30, 2017 were \$253.5 million, slightly improved from \$252.7 million recorded for the same period in 2016. Revenues in Canada increased 0.9% in the second quarter of 2017 in comparison to the same period in 2016, primarily driven by the strengthening of the United States dollar relative to the Canadian dollar, offset by lower production volume. On a currency neutral basis, Canadian revenues in the second quarter of 2017 decreased by 1.5% over the same period of 2016.

Revenues in United States declined by 8.0% in the second quarter of 2017 compared to the second quarter of 2016 when measured in Canadian dollars mainly due to volume decrease partially offset by favourable foreign exchange impact due to the strengthening of the United States dollar against the Canadian dollar. On a currency neutral basis, revenues in the United States decreased 11.8% in the second quarter of 2017 over the same period in 2016.

European revenues increased 8.8% in the second quarter of 2017 compared to the same period in 2016 primarily driven by increased production rates for both single and wide body aircraft and a favourable foreign exchange impact as the United States dollar strengthened relative to the British pound. On a constant currency basis, revenues in the second quarter of 2017 in Europe went up by 5.8% compared to the same period in 2016.

### Gross Profit

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2017	2016	Change	2017	2016	Change
Gross profit	<b>46,221</b>	45,946	0.6%	<b>89,429</b>	94,471	(5.3%)
Percentage of revenues	<b>18.2%</b>	18.2%		<b>17.9%</b>	18.2%	

Gross profit of \$46.2 million for the second quarter of 2017 was relatively consistent with the \$45.9 million for the second quarter of 2016, and gross profit as a percentage of revenues of 18.2% was reported in each quarter of both years. The gross profit in the current quarter was impacted by the favourable foreign exchange due to the strengthening year over year of the United States dollar against the Canadian dollar and the British pound, offset by the lower production volume and unfavourable foreign exchange impact resulted from the weakening British pound against the Canadian dollar.

### Administrative and General Expenses

Expressed in thousands of dollars	Three month period ended June 30			Six month period ended June 30		
	2017	2016	Change	2017	2016	Change
Administrative and general expenses	<b>15,776</b>	13,583	16.1%	<b>30,863</b>	28,782	7.2%
Percentage of revenues	<b>6.2%</b>	5.4%		<b>6.2%</b>	5.5%	

Administrative and general expenses as a percentage of revenues of 6.2% for the second quarter of 2017 were 0.8% higher than that in the corresponding period of 2016. Administrative and general expenses increased \$2.2 million or 16.1% to \$15.8 million in the second quarter of 2017 compared to \$13.6 million in the second quarter of 2016 mainly due to the recognition of a \$1.3 million legal settlement recovery recorded in the second quarter of the prior year.

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#### Other

	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Foreign exchange loss (gain)	2,216	(962)	3,092	(849)
Business closure costs	-	2,208	-	2,208
Loss (gain) on disposal of property, plant and equipment	5	61	(26,588)	185
Other	-	-	4,010	-
<b>Total other</b>	<b>2,221</b>	<b>1,307</b>	<b>(19,486)</b>	<b>1,544</b>

Other expense of \$2.2 million for the second quarter of 2017 consisted of \$2.2 million foreign exchange loss compared to a \$1.0 million foreign exchange gain recorded in the same period of 2016. 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 recorded a \$2.2 million charge related to closure of a small operating facility in the United States.

#### Interest Expense

	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Interest on bank indebtedness and long-term debt	523	890	1,392	2,171
Accretion charge on borrowings and long-term debt	252	260	486	467
Discount on sale of accounts receivable	512	316	764	647
<b>Total interest expense</b>	<b>1,287</b>	<b>1,466</b>	<b>2,642</b>	<b>3,285</b>

Total interest expense of \$1.3 million in the second quarter of 2017 was \$0.2 million lower than the second quarter of 2016 amount of \$1.5 million, mainly due to lower interest on bank indebtedness driven by lower principal amounts outstanding during the second quarter of 2017 than the same period in 2016, offset by higher discount on sale of accounts receivables resulting from higher interest rates charged under the securitization program for the second of quarter of 2017 compared to the second quarter of 2016.

#### Provision for Income Taxes

	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Current income tax expense	4,070	4,159	8,632	7,747
Deferred income tax expense	2,496	3,110	6,994	7,364
<b>Income tax expense</b>	<b>6,566</b>	<b>7,269</b>	<b>15,626</b>	<b>15,111</b>
<b>Effective tax rate</b>	<b>24.4%</b>	<b>24.6%</b>	<b>20.7%</b>	<b>24.8%</b>

Income tax expense for the three months ended June 30, 2017 was \$6.6 million, representing an effective income tax rate of 24.4% compared to 24.6% for the same period of 2016. The decrease in effective tax rate and the deferred income tax expense year over year was primarily due to change in mix of income across the different jurisdictions in which the Corporation operates.

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### 3. Selected Quarterly Financial Information

A summary view of Magellan’s quarterly financial performance

Expressed in millions of dollars, except per share amounts	2017		2016			2015		
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Revenues	253.5	247.2	247.1	238.0	252.7	266.1	252.6	236.2
Income before taxes	26.9	48.5	31.3	25.2	29.6	31.3	27.1	24.8
Net Income	20.4	39.4	24.0	18.8	22.3	23.4	25.5	18.5
Net Income per share								
Basic and diluted	0.35	0.68	0.41	0.32	0.38	0.40	0.44	0.32
EBITDA <sup>1</sup>	40.4	62.3	45.3	38.4	44.7	45.8	43.1	37.8

<sup>1</sup> 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 the first quarter of 2016. Revenues and net income reported in the table above were impacted by the movements in the Canadian dollar relative to the United States dollar and British pound when the Corporation translates its foreign operations to Canadian dollars. Further, the movements in the United States dollar relative to British pound impact the Corporation’s United States dollar exposures in its European operations. During the periods reported, the average exchange rate of United States dollar relative to the Canadian dollar fluctuated between a high of 1.3748 in the first quarter of 2016 and a low of 1.2885 in the second quarter of 2016. The average exchange rate of British pound relative to the Canadian dollar moved from a high of 2.0280 in the third quarter of 2015 to a low of 1.6398 in the first quarter of 2017. The average exchange rate of the British pound relative to the United States dollar reached its high of 1.5489 in the third quarter of 2015 and hit a low of 1.2395 in the first quarter of 2017.

Revenue for the second quarter of 2017 of \$253.5 million was slightly higher than that in the second quarter of 2016. The average exchange rate of the United States dollar relative to the Canadian dollar in the second quarter of 2017 was 1.3441 versus 1.2887 in the same period of 2016. The average exchange rate of British pound relative to the Canadian dollar moved from 1.8469 in the second quarter of 2016 to 1.7194 during the current quarter. The average exchange rate of the British pound relative to the United States dollar decreased from 1.4332 in the second quarter of 2016 to 1.2782 in the current quarter. Had the foreign exchange rates remained at levels experienced in the second quarter of 2016, reported revenues in the second quarter of 2017 would have been lower by \$7.8 million.

The Corporation reported its highest net income in the first quarter of 2017 mainly driven by the recording of the gain on the sale of the land and building of its Mississauga facility. As discussed above, net income reported in the quarterly information was also impacted by the foreign exchange movements. The Corporation recorded business closure costs related to the closure of a small operating facility in the United States in the second quarter of 2016, and a margin adjustment related to one of its construction contracts in the third quarter of 2016. In the fourth quarter of 2015, the Corporation recognized an adjustment in corporation taxation rates in the income tax jurisdictions in which the Corporation operates.

### 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.

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	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Net income	20,371	22,321	59,784	45,749
Interest	1,287	1,466	2,642	3,285
Taxes	6,566	7,269	15,626	15,111
Depreciation and amortization	12,221	13,686	24,692	26,423
EBITDA	40,445	44,742	102,744	90,568

EBITDA decreased \$4.3 million or 9.6% to \$40.4 million for the second quarter of 2017, compared to \$44.7 million in the second quarter of 2016 as a result of lower net income, interest, 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, capital expenditures and dividend payments. 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

	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Decrease (increase) in accounts receivable	7,119	293	(20,359)	(18,143)
Decrease (increase) in inventories	1,678	(7,798)	(3,112)	(10,117)
(Increase) decrease in prepaid expenses and other	(628)	(133)	233	506
Decrease in accounts payable, accrued liabilities and provisions	(9,999)	(7,089)	(20,402)	(491)
Changes in non-cash working capital balances	(1,830)	(14,727)	(43,640)	(28,245)
Cash provided by operating activities	31,361	22,360	20,589	47,761

For the three months ended June 30, 2017, the Corporation generated \$31.4 million from operating activities, compared to \$22.4 million in the second quarter of 2016. The increase in cash flow from operations was significantly impacted by the favourable movement in non-cash working capital balances, largely due to decrease in accounts receivables resulted from timing of collection and decreases in inventories mainly due to timing of shipment, offset by decreases in accounts payable, accrued liabilities and provisions due to timing of payments and the partial settlement of contingent liabilities.

### Investing Activities

	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Expressed in thousands of dollars				
Purchase of property, plant and equipment	(9,550)	(7,956)	(26,142)	(11,590)
Proceeds of disposals of property, plant and equipment	17	4	32,678	163
Increase in intangible and other assets	(9,013)	(2,410)	(5,893)	(7,055)
Change in restricted cash	3,686	4,449	3,665	5,225
Cash (used in) provided by investing activities	(14,860)	(5,913)	4,308	(13,257)

Cash used in investing activities for the second quarter of 2017 was \$14.9 million compared to \$5.9 million in the same quarter of 2016, an increase of \$9.0 million primarily due to higher investment in property, plant and equipment, and intangible assets. The Corporation continues to invest in capital expenditures to enhance its manufacturing capabilities in various geographies and to support new customer programs.

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### Financing Activities

Expressed in thousands of dollars	Three month period ended June 30		Six month period ended June 30	
	2017	2016	2017	2016
Decrease in bank indebtedness	(6,103)	(18,509)	(19,165)	(29,213)
(Decrease) increase in debt due within one year	(554)	4,923	4,807	2,706
Decrease in long-term debt	(1,215)	(1,143)	(2,329)	(2,251)
Increase in long-term liabilities and provisions	86	461	1,140	208
Increase in borrowings	2,021	697	2,551	807
Common share dividend	(3,783)	(3,347)	(7,567)	(6,694)
Cash used in financing activities	(9,548)	(16,918)	(20,563)	(34,437)

The Corporation has an operating credit facility, with a syndicate of banks, with a Canadian dollar limit of \$95.0 million, a US dollar limit of US\$35.0 million and a British pound limit of £11.0 million. 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 Canadian \$50.0 million uncommitted accordion provision which provides the Corporation with the option to increase the size of the operating credit facility.

The Corporation used \$9.5 million in the second quarter of 2017 mainly to repay bank indebtedness and pay dividends which was partially offset by the proceeds from Canadian government agency related to the development of its technologies and processes.

As at June 30, 2017 the Corporation has made contractual commitments to purchase \$17.9 million of capital assets.

### Dividends

During the second quarter of 2017, the Corporation declared and paid quarterly cash dividends of \$0.065 per common shares representing an aggregating dividend payment of \$3.8 million.

Subsequent to June 30, 2017, the Corporation announced that its Board of Directors had declared a quarterly cash dividend on its common shares of \$0.065 per common share. The dividend will be payable on September 29, 2017 to shareholders of record at the close of business on September 15, 2017.

### 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 4, 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 foreign exchange contracts outstanding as at June 30, 2017.

### 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, 2017, 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, 2016 and to the information under “Risks Inherent in Magellan’s Business” in the Corporation’s Annual Information Form for the year ended December 31, 2016, 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 following new standards, and amendments to standards and interpretations, are effective for the first time for interim periods beginning on or after January 1, 2017 and have been applied in preparing the consolidated interim financial statements.

### *Disclosure Initiative*

In 2016, the IASB issued amendments to IAS 7, Statement of Cash Flows (“IAS 7”). The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). They are effective for annual periods beginning on or after January 1, 2017, with earlier adoption permitted. On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The Corporation is not required to provide additional disclosures in its condensed interim consolidated financial statements, but will disclose additional information in its annual consolidated financial statements for the year ended December 31, 2017.

## **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, 2017, 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 2016 audited annual consolidated financial statements.

- IFRS 15, *Revenue from Contracts with Customers* (“IFRS 15”)
- IFRS 9, *Financial Instruments*
- IFRS 16, *Leases*
- Amendments to IFRS 2, *Classification and Measurement of Share-based Payment Transactions*
- IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration*
- IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments* (“IFRIC 23”)

In June 2017, IASB issued IFRIC 23 which clarifies application of recognition and measurement requirements in IAS 12, Income Taxes when there is uncertainty over income tax treatments. IFRIC 23 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

The Corporation is in the process of evaluating the impact of adopting these standards on the Corporation’s consolidated financial statements. Specifically, IFRS 15 is effective for annual periods beginning on or after January 1, 2018. The Corporation is required to retrospectively apply IFRS 15 to all contracts that are not complete on the date of initial



application. The Corporation intends to make a policy choice to restate each prior period presented and recognize the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of equity at the beginning of the earliest period presented, subject to certain practical expedients the Corporation anticipates to adopt.

The Corporation has undertaken a project to assess the impact of IFRS 15 and ensure the Corporation’s compliance with IFRS 15. The Corporation has collected an inventory of significant contracts with customers in scope for IFRS 15 assessment and identified preliminary accounting topics that may impact the Corporation’s reported results based on the review of a sample of contracts from each revenue stream. The Corporation is in the process of reviewing contracts with customers to ensure revenue recognition practices are in accordance with IFRS 15 and evaluating potential changes to revenue processes and systems. As a result, the Corporation continues to assess the impact of this standard on the consolidated financial statements and it is not yet in a position to make a reliable estimate of its impact. The Corporation will disclose the estimated financial effects of the adoption of IFRS 15 in its 2017 annual consolidated financial statements

## **11. Critical Accounting Estimates**

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

In the 2016 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, 2016 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, 2017 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 2017

In the 2nd quarter of 2017 Magellan Aerospace participated in the 52nd Paris International Air Show which was held between June 19th and June 25th 2017. Although trade attendance was slightly lower than in 2015, Magellan was successful in achieving its goals of furthering various strategic discussions with all major customers. During the show, Boeing announced orders and commitments totalling 571 aircraft including 361 orders for the B737 MAX. Boeing also increased its 20-year forecast from 39,000 new aircraft to more than 41,000 valued at \$6.1 trillion, which represents a doubling of the active fleet of commercial aircraft by 2023. Airbus announced 326 aircraft orders in Paris, which included 150 new A320 NEO’s.

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Paris was also the stage upon which Boeing unveiled the notional new midsize airplane dubbed “NMA”. The new twin-aisle design is intended to fill a miss-served market sized (previously serviced by the B757) between 220 and 270 seats with a range of 5,200 nautical miles.

Boeing’s latest build schedule confirms the B737 single aisle rate will go from 42 per month to 47 per month in Q3-2017, then 52 per month in 2018, and 57.7 per month in 2019. Airbus has revised their A320 family CEO/NEO mix to increase 2017 CEO builds by 30 aircraft and to reduce 2017 NEO builds by a similar number. Total A320 numbers remain unchanged with the build rate reaching 55 per month in 2017 and ramping up to a peak of 60 plus A/C per month in 2019.

The twin-aisle commercial aircraft market remains somewhat flat. Boeing’s 777 production rate has reduced from 7 per month to 5 aircraft per month. The B787 rate will hold at 12 A/C per month. Airbus’ A380 rate will drop from 1.06 per month to 0.92 per month late in 2017, and the A330 holds at 7 per month. On the positive side, the A350XWB is planning to ramp up from 8.4 per month to 13 per month by 2020. As well, Boeing’s B767 build rate is increasing due to the KC-46 tanker program. It will go from 2 per month to 2.5 per month in the 4th quarter of 2017.

Persistently low fuel prices continue to be a disruptive factor in the regional turboprop market. As a result orders for the two main competitors, Bombardier and ATR, are expected to moderate. Despite this subdued outlook, a new entrant to the market was confirmed at the Paris airshow with P&WC’s announcement it had signed an agreement to supply PW150C engines to AVIC for its new MA700 regional turboprop. AVIC hopes to secure one third of the global turboprop market with this new aircraft.

The regional jet market is seeing growth propelled by new aircraft such as Bombardier’s CS100, Embraer’s E2 family and Mitsubishi’s MRJ. Demand in this market is moving towards larger capacity aircraft that are unencumbered by U.S. airline scope clauses. Magellan does provide some support in this market sector.

Industry experts are suggesting that the business jet market is finally seeing some slow growth potential. Forecast International predicts that annual production in this market will rise slowly over the next several years.

The global rotorcraft market continues to struggle, particularly on the civil side. A sluggish oil and gas sector, which is a significant portion of this segment, is not expected to see improvement for at least another year or two. Other civil rotorcraft segments are faring slightly better with the introduction of several new models helping to stimulate growth. Military helicopter production rose in 2016 for the first time since 2013 and is expected to continue through 2017 as defence spending increases.

The outlook for legacy U.S. fighters is improving. Boeing says current orders will continue F-15 production through 2019 and claims that near-term deals could push production into late 2022. As for F/A-18, the U.S. Navy has decided to keep buying Super Hornets alongside F-35 to meet an immediate need for strike fighters. President Trump’s latest budget plan would add funding for up to 80 F/A-18E/F Super Hornets through 2022 if approved. Kuwait has been approved for up to 40 F/A-18E/F’s with India and Finland being potential new opportunities. Canada’s requirements for an “interim” fleet of 18 aircraft are on hold due to the trade dispute launched by Boeing over government subsidies to Bombardier on C-Series.

The aerospace community saw for the first time, the F-35 perform a flight demonstration during the Paris Air Show. The F-35 is expected to dominate the competition within the fighter market over the next 10 years and beyond. The program is now making plans to contract the next tranche of aircraft by combining quantities from Lots 12, 13, and 14 into one procurement for over 440 aircraft. Lockheed would engage the supply chain based on the same quantities. The U.S. Government budgeting process related to defence spending in the United States has progressed to the Armed Services Committees. Both the Senate and the House committees have increased the quantities of F-35 to be purchased in fiscal year 2018. The Senate Armed Services Committee has recommended increasing the quantity of F-35’s by 24 (to 94 from 70 originally requested). The Budget Control Act may influence the final quantities of aircraft to be purchased as the National Defense Authorization Act continues through the congressional process.

In summary, as Boeing and Airbus ramp up single aisle aircraft production to fulfil their record order backlogs, other segments of the aerospace industry are working to stimulate growth. Regional turboprops are dampened by low fuel prices while new regional jets aircraft ramp up production. The civil rotorcraft market continues to be soft, while the defence segment is seeing some growth because of increasing defence budgets. Finally, despite that there are many players for few customers in the fighter market; certain maturing fighter programs are enjoying extended production activity.