

MAGELLAN

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2019



Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

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 month period ended March 31, 2019, and the audited annual consolidated financial statements for the year ended December 31, 2018 (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 March 31, 2019 relative to the three month period ended March 31, 2018. The information contained in this report is as at May 7, 2019. 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.

Business Update

On February 20, 2019, Magellan announced it has increased its investment in Triveni Aeronautics Private Limited (“Triveni”), an aerospace parts manufacture located in Tumkur, Karnataka, India to 75%. Magellan’s investment in Triveni commenced in 2013 when it acquired a 49% share of the business.

On March 15, 2019, Magellan announced agreements valued at \$48 million with the Canadian government to perform the licensed manufacture of LUU-2 Illumination flares for the Royal Canadian Air Force. Magellan-produced flares will be

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

delivered from the Magellan’s propellant plant, located near Winnipeg, Manitoba, Canada. The term of the contract is five years.

On April 12, 2019, Magellan announced an agreement with Atlas Elektronik Canada for the design and development phase of the SeaSpider® Anti Torpedo Torpedo (ATT) program. The initial \$19 million phase of the program was launched in January 2019 and is expected to conclude in 2023. Magellan will lead the design and development of the SeaSpider® ATT rocket motor and warhead section of the torpedo that includes design, build, test and production qualification.

On April 24, 2019, Magellan announced it has reached a multi-year agreement with The Boeing Company (“Boeing”) to manufacture 777X control surface ribs in support of Boeing’s Focused Factory initiative. Magellan will provide internal dual source capability for risk mitigation and business continuity. Work will begin at its United Kingdom facility and later transition to a new factory in Bangalore, India. Boeing’s Focused Factory initiative is the aggregation of products grouped by commonality and forecasted demand. The product groups utilize similar technologies and aggregating the products creates economies of scale that deliver lower cost, improved quality, and delivery efficiencies.

On April 29, 2019, Magellan announced agreements with an undisclosed customer for the supply of complex fabricated engine front frames for a commercial platform, to be manufactured at Magellan’s facility in Winnipeg, Manitoba, Canada, and critical rotating engine shafts for a dual use platform, to be manufactured at Magellan’s facility in Haverhill, Massachusetts, USA. These agreements are valued at approximately \$45 million and will be delivered starting in 2019 through 2022.

For additional information, please refer to the “Management’s Discussion and Analysis” section of the Corporation’s 2018 Annual Report available on www.sedar.com.

2. Results of Operations

A discussion of Magellan’s operating results for the first quarter ended March 31, 2019

The Corporation reported revenue in the first quarter of 2019 of \$269.9 million, a \$25.3 million increase from the first quarter of 2018 of \$244.6 million. Gross profit and net income for the first quarter of 2019 were \$42.8 million and \$20.4 million, respectively, in comparison to gross profit of \$40.4 million and net income of \$17.5 million for the first quarter of 2018.

Consolidated Revenue

Expressed in thousands of dollars	Three month period ended March 31		
	2019	2018	Change
Canada	90,701	78,656	15.3%
United States	84,819	79,576	6.6%
Europe	94,364	86,393	9.2%
Total revenues	269,884	244,625	10.3%

Consolidated revenues for the three month period ended March 31, 2019 were \$269.9 million, an increase of \$25.3 million from \$244.6 million recorded for the same period in 2018. Revenues in Canada increased 15.3% in the first quarter of 2019 compared to the corresponding period in 2018, primarily due to volume increases, new contract awards, and the strengthening of the United States dollar relative to the Canadian dollar when compared to the prior period. On a currency neutral basis, Canadian revenues in the first quarter of 2019 increased by 11.9% over the same period of 2018.

Revenues in the United States increased by 6.6% in the first quarter of 2019 when compared to the first quarter of 2018 mainly due to volume increases in wide body aircraft and favourable foreign exchange impact due to the strengthening of the United States dollar against the Canadian dollar. On a currency neutral basis, 2019 first quarter revenues in the United States increased 1.6% over the same period in 2018.

European revenues in the first quarter of 2019 increased 9.2% when compared to the corresponding period in 2018 primarily driven by increased production rates for single aisle and wide body aircraft, as well as the strengthening of the United States dollar relative to the British pound, offset in part by an unfavourable foreign exchange impact as a result of the weakening of the British pound relative to the Canadian dollar. On a constant currency basis, revenues in the first quarter of 2019 in Europe increased 5.0% compared to the same period in 2018.

Gross Profit

Three month period
ended March 31

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

Expressed in thousands of dollars	2019	2018	Change
Gross profit	42,821	40,428	5.9%
Percentage of revenues	15.9%	16.5%	

Gross profit of \$42.8 million for the first quarter of 2019 was \$2.4 million higher than the \$40.4 million gross profit for the first quarter of 2018, and gross profit as a percentage of revenues of 15.9% for the first quarter of 2019 decreased from 16.5% recorded in the same period in 2018. The gross profit in the current quarter was primarily impacted by unfavourable product mix, production inefficiencies and the recording of an impairment charge of \$1.1 million on intangible assets offset partially by a favourable foreign exchange impact due to the strengthening of the United States dollar relative to the British pound.

Administrative and General Expenses

Expressed in thousands of dollars	2019	2018	Change
Administrative and general expenses	15,300	14,628	4.6%
Percentage of revenues	5.7%	6.0%	

Administrative and general expenses as a percentage of revenues of 5.7% for the first quarter of 2019 were slightly lower than the same period of 2018. Administrative and general expenses increased slightly by \$0.7 million or 4.6% to \$15.3 million in the first quarter of 2019 compared to \$14.6 million in the corresponding quarter of 2018 mainly due to expenses incurred for the phased implementation of a new ERP system.

Other

Expressed in thousands of dollars	2019	2018	Change
Foreign exchange loss	453	2,170	
(Gain) loss on disposal of property, plant and equipment	(85)	88	
Other	190	-	
Total other expenses	558	2,258	

Other for the first quarter of 2019 included a \$0.5 million foreign exchange loss compared to a \$2.2 million loss in the first quarter of the prior year. The movements in balances denominated in the foreign currencies and the fluctuations of the foreign exchange rates impact the net foreign exchange gain or loss recorded in a quarter. In addition, a \$0.9 million gain recorded in relation to the step acquisition of Triveni was offset by relocation expenses incurred in relation to the Corporation’s Mississauga facility.

Interest Expense

Expressed in thousands of dollars	2019	2018	Change
Interest on bank indebtedness and long-term debt	(40)	388	
Accretion charge for borrowings, lease liabilities and long-term debt	545	262	
Discount on sale of accounts receivable	563	428	
Total interest expense	1,068	1,078	

Total interest expense of \$1.1 million in the first quarter of 2019 was consistent with the first quarter of 2018 amount. Accretion charge was higher than the prior year due to adoption of IFRS 16, *Leases* effective January 1, 2019, offset by decreased interest on bank indebtedness and long-term debt as principal amounts were lower during the quarter.

Provision for Income Taxes

Expressed in thousands of dollars	2019	2018	Change
Expense of current income taxes	2,805	3,878	
Expense of deferred income taxes	2,681	1,122	
Total expense of income taxes	5,486	5,000	
Effective tax rate	21.2%	22.3%	

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

Income tax expense for the three months ended March 31, 2019 was \$5.5 million, representing an effective income tax rate of 21.2% compared to 22.3% for the same period of 2018. The change in effective tax rate and current and deferred income tax expenses year over year was primarily due to the change in mix of income across the different jurisdictions in which the Corporation operates.

3. Selected Quarterly Financial Information

A summary view of Magellan’s quarterly financial performance

Expressed in millions of dollars, except per share amounts	2019				2018			
	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31 ²	Sep 30 ²	Jun 30 ²
Revenues	269.9	254.4	226.5	241.2	244.6	232.7	222.6	252.0
Income before taxes	25.9	38.5	23.4	29.8	22.5	28.4	23.6	26.3
Net Income	20.4	29.5	18.6	23.5	17.5	31.9	18.1	19.9
Net Income per share								
Basic and diluted	0.35	0.51	0.32	0.40	0.30	0.55	0.31	0.34
EBITDA ¹	40.5	50.7	35.5	41.8	34.1	40.1	35.8	39.5

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

² Restated using revenue recognition policies in accordance with IFRS 15, *Revenue from Contracts with Customers*.

Revenues and net income reported in the quarterly financial information 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 the British pound impact the Corporation’s United States dollar exposures in its European operations. During the periods reported, the average exchange rate of the United States dollar relative to the Canadian dollar fluctuated between a high of 1.3448 in the second quarter of 2017 and a low of 1.2526 in the third quarter of 2017. The average exchange rate of the British pound relative to the Canadian dollar moved from a high of 1.7607 in the first quarter of 2018 to a low of 1.6398 in the third quarter of 2017. The average exchange rate of the British pound relative to the United States dollar reached its high of 1.3920 in the first quarter of 2018 and hit a low of 1.2791 in the second quarter of 2017.

Revenue for the first quarter of 2019 of \$269.9 million was higher than that in the first quarter of 2018. The average exchange rate of the United States dollar relative to the Canadian dollar in the first quarter of 2019 was 1.3292 versus 1.2648 in the same period of 2018. The average exchange rate of the British pound relative to the Canadian dollar moved from 1.7607 in the first quarter of 2018 to 1.7315 during the current quarter. The average exchange rate of the British pound relative to the United States dollar decreased from 1.3920 in the first quarter of 2018 to 1.3027 in the current quarter. Had the foreign exchange rates remained at levels experienced in the first quarter of 2018, reported revenues in the first quarter of 2019 would have been lower by \$4.0 million.

As discussed above, net income reported in the quarterly information was also impacted by the foreign exchange movements. In the third quarter of 2017, the Corporation recorded a gain of \$2.2 million on the disposition of an investment property. In the fourth quarter of 2017, the Corporation recognized the future tax benefit attributable to a reduction in the United States federal corporate income tax as a result of new legislation. In the fourth quarter of 2018, the Corporation recorded a net gain of \$9.7 million related to prior acquisitions.

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.

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

	Three month period ended March 31	
	2019	2018
Expressed in thousands of dollars		
Net income	20,409	17,464
Interest	1,068	1,078
Taxes	5,486	5,000
Depreciation and amortization	13,530	10,596
EBITDA	40,493	34,138

EBITDA in the first quarter of 2019 increased \$6.4 million or 18.8% to \$40.5 million, in comparison to \$34.1 million in the same quarter of 2018 mainly as a result of higher net income and an increase in depreciation and amortization expense mainly due to the implementation of new accounting standard.

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 March 31	
	2019	2018
Expressed in thousands of dollars		
Increase in trade receivables	(22,706)	(16,203)
Increase in contract assets	(11,736)	(6,799)
(Increase) decrease in inventories	(2,062)	3,864
Increase in prepaid expenses and other	(2,826)	(3,062)
Increase (decrease) in accounts payable, accrued liabilities and provisions	12,416	(14,327)
Changes to non-cash working capital balances	(26,914)	(36,527)
Cash provided by (used in) operating activities	8,098	(8,595)

For the three months ended March 31, 2019, the Corporation generated \$8.1 million from operating activities, compared to \$8.6 million used in the first quarter of 2018. The increase in cash flow from operations was mainly impacted by the favourable change in non-cash working capital balances, largely resulted from the favourable change year over year in accounts payable, accrued liabilities and provisions due to the nature of purchases and timing of payments. This was offset by the increases in trade receivables and contract assets, which resulted from higher sales and timing of production and billing related to products transferred over time, and higher inventories due to higher production demand.

Investing Activities

	Three month period ended March 31	
	2019	2018
Expressed in thousands of dollars		
Business combination, net of cash acquired	(2,661)	-
Purchase of property, plant and equipment	(9,507)	(7,566)
Proceeds of disposal of property plant and equipment	235	21
Increase in intangible and other assets	(6,066)	(754)
Change in restricted cash	-	(2,714)
Cash used in investing activities	(17,999)	(11,013)

Investing activities used \$18.0 million cash for the first quarter of 2019 compared to \$11.0 million cash used in the same quarter of the prior year, an increase of \$7.0 million primarily due to the step acquisition of Triveni, higher level of investment in property, plant and equipment, an investment in a new ERP system and higher deposits recorded in other assets. The

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

Corporation continues to invest in capital expenditures to enhance its manufacturing capabilities in various geographies and to support new customer programs.

Financing Activities

	Three month period ended March 31	
Expressed in thousands of dollars	2019	2018
(Decrease) increase in bank indebtedness	(42)	15,446
Decrease in debt due within one year	(6,884)	(7,033)
Decrease in long-term debt	(647)	(13,266)
Decrease in lease liabilities	(901)	-
Decrease in long-term liabilities and provisions	(35)	(74)
Increase in borrowings subject to specific conditions	-	25
Common share dividend	(5,821)	(4,948)
Cash used in financing activities	(14,330)	(9,850)

On September 13, 2018, the Corporation amended its credit agreement with its existing lenders. The Corporation has a multi-currency operating credit facility with a syndicate of banks, with a Canadian dollar limit of \$75 million. Under the terms of the amended credit agreement, the operating credit facility expires on September 13, 2020. Extensions of the facility are subject to mutual consent of the syndicate of lenders and the Corporation. The credit agreement also includes a \$75 million uncommitted accordion provision which will provide the Corporation with the option to increase the size of the operating credit facility.

The Corporation used \$14.3 million in the first quarter of 2019 mainly to repay debt due within one year, long-term debt and lease liabilities, and to pay dividends.

As at March 31, 2019, the Corporation had made contractual commitments to purchase \$7.2 million of capital assets.

Dividends

During the first quarter of 2019, the Corporation declared and paid quarterly cash dividends of \$0.10 per common shares representing an aggregating dividend payment of \$5.8 million.

Subsequent to March 31, 2019, the Corporation announced that its Board of Directors had declared a quarterly cash dividend on its common shares of \$0.10 per common share. The dividend will be payable on June 28, 2019 to shareholders of record at the close of business on June 14, 2019.

Outstanding Share Information

The authorized capital of the Corporation consists of an unlimited number of Preference Shares, issuable in series, and an unlimited number of common shares. As at May 7, 2019, 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. As at March 31, 2019, the Corporation had \$30.0 million USD/CAD foreign exchange contracts outstanding with a fair value liability of \$0.3 million, expiring monthly until December 2019.

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

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

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 month period ended March 31, 2019, 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, 2018 and to the information under “Risks Inherent in Magellan’s Business” in the Corporation’s Annual Information Form for the year ended December 31, 2018, 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, 2019 and have been applied in preparing the consolidated interim financial statements.

Leases

Effective January 1, 2019, the Corporation adopted IFRS 16, *Leases* (“IFRS 16”), replacing IAS 17, *Leases* (“IAS 17”), IFRIC 4, *Determining whether an Arrangement contains a Lease* (“IFRIC 4”), SIC-15, *Operating Leases-Incentives* and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

IFRS 16 introduced a single on-balance sheet model for lessees unless the underlying asset is of low value and recognition exemption applied. A lessee is required to recognize, on its statement of financial position, a right-of-use asset, representing its right to use the underlying leased asset, and a lease liability, representing its obligation to make lease payments. As a result of adopting IFRS 16, the Corporation recognized a \$24.2 million increase to assets and liabilities, respectively, on the condensed consolidated interim statement of financial position. Subsequent to the adoption, operating costs decrease due to the removal of rent expense for leases, depreciation and amortization expense increases due to depreciation of right-of-use assets, and finance costs increase due to accretion of the lease liability. The accounting treatment for lessors remains largely the same as under IAS 17.

The Corporation adopted IFRS 16 under the modified retrospective approach and did not restate the comparatives for 2018. At transition, the Corporation applied the practical expedient available to the Corporation as lessee that allows the continuation of the lease assessments under IAS 17 and IFRIC 4 for existing contracts. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered into or changed after January 1, 2019.

For leases that were classified as operating leases under IAS 17, lease liabilities at transition have been measured at the present value of remaining lease payments, discounted at the incremental borrowing rate as at January 1, 2019. Right-of-use assets at transition have been measured at an amount equal to the corresponding lease liabilities, adjusted for any prepaid or accrued rent relating to that lease.

When applying IFRS 16 to leases previously classified as operating leases, the following practical expedients were applied:

- a single discount rate to a portfolio of leases with similar characteristics;
- used hindsight in determining the lease term where the contract contains purchase, extension, or termination options;
- relied upon our assessment of whether leases are onerous under the requirements of IAS 37, *Provisions, contingent liabilities and contingent assets* as at December 31, 2018 as an alternative to reviewing our right-of-use assets for impairment; and
- excluded short-term leases or low-value leases.

There was no significant impact for contracts in which the Corporation is the lessor.

Prior to adopting IFRS 16, the total minimum operating lease commitments as at December 31, 2018 were \$37.9 million. The weighted average discount rate applied to the total lease liabilities recognized on transition was 3.82%. The difference between the total of the minimum lease payments set out in Note 21 to the 2018 annual consolidated financial statements and the total lease liabilities recognized on transition was a result of:

- the effect of discounting on the minimum lease payments;
- the exclusion of lease payments related to reasonably certain termination options that have not yet been exercised as at December 31, 2018; and
- the exclusion of short-term leases.

Accounting pronouncements adopted

The following pronouncements were adopted by the Corporation as of January 1, 2019 and do not have an impact on the Corporation’s condensed consolidated interim financial statements. These changes are described in detail in the Corporation’s 2018 consolidated financial statements.

- IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments*
- Amendments to IAS 19, *Plan Amendment, Curtailment or Settlement*
- Annual Improvements to IFRS Standards 2015 – 2017: IFRS 3, *Business Combination*
- Annual Improvements to IFRS Standards 2015 – 2017: IAS 12, *Income Taxes*

10. Critical Accounting Estimates

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

In the 2018 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, 2018 for a discussion regarding the critical accounting estimates.

11. 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 March 31, 2019 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.

12. Outlook

The outlook for Magellan’s business in 2019

The commercial aerospace market is expected to continue to grow in 2019. Industry experts suggest that this market will maintain its strength until at least 2022 considering current order backlogs. As of March 31, 2019, Airbus’ record backlog was at 7,357 jets on order, representing 9.2 years at 2018 rates. Boeing’s record backlog in 2018 reached 5,893 aircraft or 7.3 years of production at 2018 rates.

In the single aisle market and following the recent incident involving a 737 MAX 8 aircraft, Boeing announced they would temporarily reduce the 737 production rate from 52 aircraft per month to 42 per month. It is expected this lower rate will continue through the second quarter of 2019 and is expected to resume at the higher rate sometime in the third quarter of 2019. The impact of the lower production rate continues to be assessed by the Corporation as additional information is obtained. Airbus is currently producing the A320 at a rate of 56 aircraft per month, with plans to reach 63 aircraft per month by September 2019.

In the large commercial aircraft market, Boeing’s 787 program build rates are expected to increase from 12 aircraft per month to 14 aircraft per month by the end of the second quarter of 2019. The 777 program rate remains steady at 5 aircraft per month, and Boeing plans to build six 747 aircraft in 2019. Boeing delivered three 777X’s in 2018 and is expected to deliver three in 2019. The 777X production ramp up begins in 2020. Airbus’ A330 build rate is at a stable 4.5 per month. The A350XWB rate increased from 8.8 aircraft per month to 9.8 aircraft per month in late 2018. Consideration is being made to hit 13 aircraft per month in 2020.

On February 14, 2019 Airbus announced that it will wind down the A380 program following the cancelation of 39 aircraft orders by the program’s largest customer, Emirates. Emirates will take delivery of only 14 more aircraft over the next two years and will instead order 40 of the A330-900 and 30 of the A350-900 twin-engine widebody aircraft. Airbus stated that the final A380 program deliveries will be in 2021. Airbus’ remaining order backlog for the A380 is at 17 aircraft. The Corporation’s participation on this aircraft platform is valued at approximately \$2.3 million per shipset. The impact of the program wind down continues to be assessed, however the Corporation recorded a provision in the first quarter of 2019.

The competitive landscape within the commercial aircraft industry has been changing as vertical integration strategies and mergers and acquisitions shift market advantage. With UTC’s acquisition of Collins Aerospace, UTC is now capable of supplying all major aircraft systems except for the airframe and could effectively compete with the original equipment manufacturers by partnering with an independent airframe supplier to build an aircraft. Industry experts suggest that Boeing’s outsourcing strategy on the 787 program seeded this new type of super Tier I. Boeing is moving away from that strategy on the 777X program in favour of in-sourcing and using non-Tier I suppliers. Magellan has recently benefited from this strategy change through the award of a new multi-year agreement to manufacture 777X control surface ribs in support of Boeing’s Focused Factory initiative.

The helicopter industry expects to see growth come from the Emergency Medical Services (“EMS”) segment which could account for 18 to 20 percent of global demand. China in particular is expected to generate a significant portion of this new demand for EMS helicopters. The oil and natural gas helicopter market remains flat as it is still dealing with an underutilized fleet. On the defence helicopter side, the United States Army continues development on the Future Vertical Lift (“FVL”) and Future Attack (“FA”) programs as well as the Improved Turbine Engine Program (“ITEP”), which is meant to re-engine the Boeing AH64 and Sikorsky UH-60 helicopters. General Electric’s T901 engine recently won the ITEP engine competition beating out Pratt & Whitney/Honeywell’s T900 engine. The FVL and FA program platform decisions are further out in the future.

In the defence market, resurging threats from Russia and China are causing NATO countries to shift budget priorities toward fleet modernization. Past underinvestment in these areas is considered a liability in the ability to maintain defence superiority, especially as technology advancements are being made by both Russia and China. The fiscal United States defence budget is expected to rise over the next two years, which will secure growth for the United States defence prime contractors through at least 2023.

In Canada, the Future Fighter Replacement Program is progressing with four of the original five aircraft continuing in the competition, Lockheed Martin’s F-35, Boeing’s Super Hornet, the Eurofighter Typhoon, and Saab’s Gripen. A draft request for proposal (“RFP”) was issued to the bidders for review and comment in 2018 with a final RFP expected to be issued in the second quarter of 2019. Bid responses will be requested for the fourth quarter of 2019, with a down selection expected in 2020 /2021 followed by a contract award in 2022. The first aircraft delivery is expected to be in 2025.

Magellan Aerospace Corporation – Management’s Discussion & Analysis

March 31, 2019

Regarding the F-35 Lightning II program, Lockheed Martin announced that it had met its 2018 target by delivering 91 F-35 aircraft last year. This represented a 40% increase over 2017 deliveries and 100% over 2016. For 2019, Lockheed is set to deliver over 130 aircraft. Lockheed also announced that it delivered targeted cost reductions across all three variants of the aircraft. They continue to record new orders for the F-35 with Japan announcing at the end of 2018, a commitment to acquire 105 additional aircraft beyond the 42 F-35’s already approved. Singapore announced in January 2019 a decision to select the F-35 as a successor to their fleet of F-16’s with a final decision expected later in the year.

Magellan is currently optimizing its facilities to accommodate increased F-35 production rates. By the end of 2019, Magellan will be capable of supporting 60 shipsets of horizontal tails per year for the F-35.