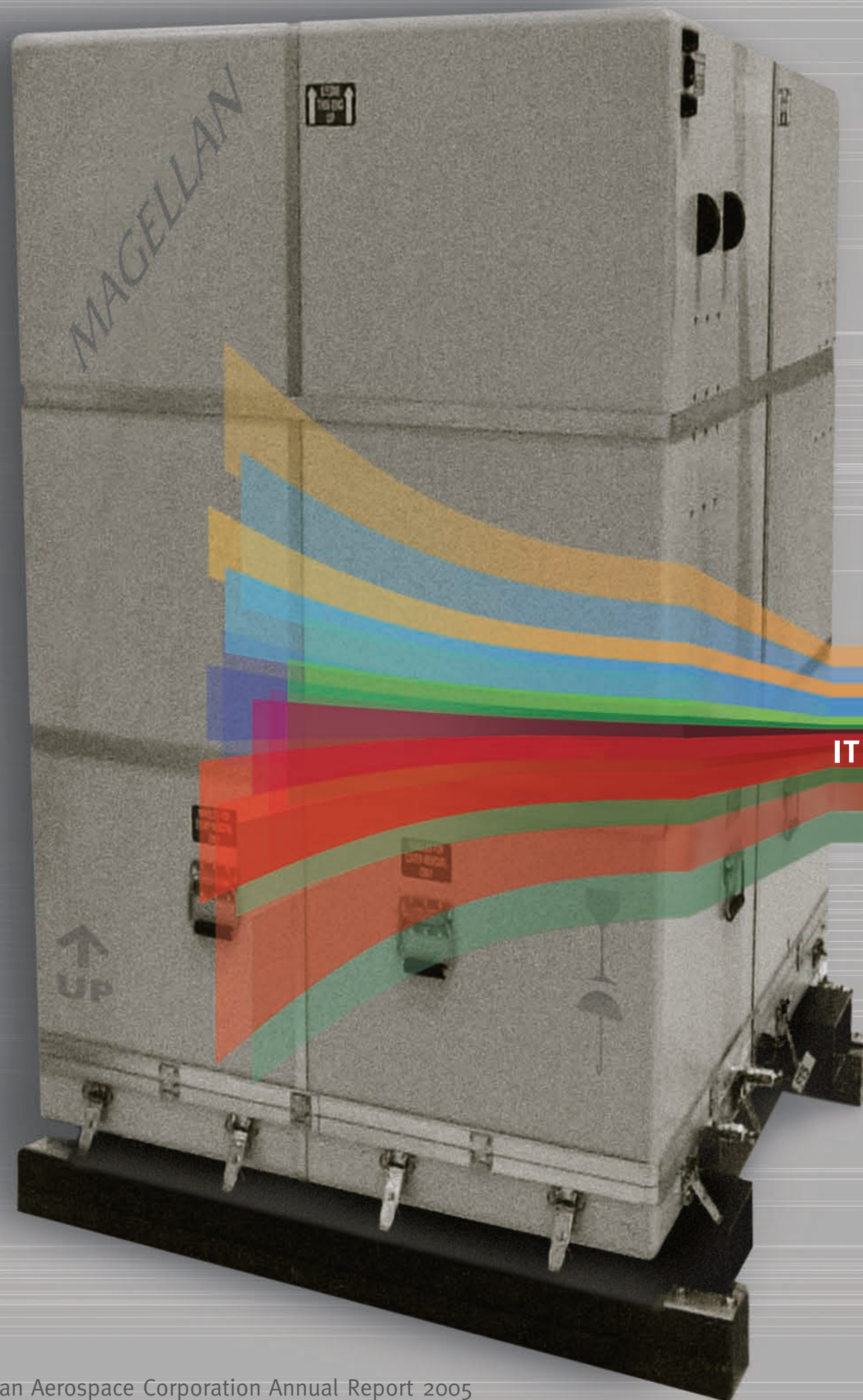

Magellan Aerospace Corporation Annual Report 2005

MAGELLAN
AEROSPACE CORPORATION

MAGELLAN AEROSPACE CORPORATION DESIGNS, ENGINEERS, MANUFACTURES AND INTEGRATES AEROENGINE AND AEROSTRUCTURE ASSEMBLIES FOR AEROSPACE MARKETS, AND ADVANCED PRODUCTS FOR MILITARY, SPACE AND POWER GENERATION MARKETS WITH ALIGNED OPERATIONS, SUPPLIER MANAGEMENT, MARKETING, AND PRODUCT DEVELOPMENT ACROSS ALL OPERATING DIVISIONS.

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Financial Highlights

(Expressed in thousands except per share data)	2005	2004 (restated)	Percentage Change
Revenues	**$ 568,483**	$ 573,779	-0.9%
Net loss for the year	**(6,076)**	(8,164)	–
Loss per common share	**(0.08)**	(0.10)	–
EBITDA	**37,448**	37,018	1.2%
EBITDA per common share	**0.41**	0.45	-8.9%
Capital expenditures	**19,185**	16,936	13.3%
Shareholders' equity	**307,743**	303,643	1.4%

Notes to Reader

1. This annual statement contains certain forward-looking statements that reflect the current views and/or expectations of Magellan Aerospace Corporation (the "Corporation") with respect to its performance, business and future events. Such statements are subject to a number of risks, uncertainties and assumptions which may cause actual results to be materially different from those expressed or implied. The Corporation does not accept any obligations to release publicly any updates or revisions to any forward-looking statements to reflect any changes in the Corporation's expectations.

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

Message to shareholders

It's All In The Process

N. Murray Edwards Chairman

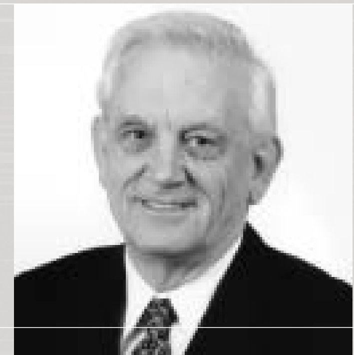
MAGELLAN'S OPERATIONS PROCESSES BEGIN EARLY IN THE CUSTOMER'S CONCEPTUAL DESIGN PHASE, ADDING VALUE THROUGH INTEGRATED PRODUCT DEVELOPMENT TEAMS, WITH DETAIL DESIGN, MANUFACTURABILITY INPUT AND PROTOTYPING OF COMPONENTS AND ASSEMBLIES FOR AIRCRAFT, TURBINE ENGINES, ROCKET MOTOR AND SPACE HARDWARE SYSTEMS AND SPECIALTY PRODUCTS.

The aerospace market had a good year in 2005. In the civil sector, orders were placed for a record number of aircraft, while sales of business aircraft grew strongly. Regional turboprops made a comeback from near extinction, while regional jet demand continued a rapid shift from 50-seat to 100-seat layouts. New defence aircraft and engine programs progressed, and aftermarket sales in civil and defence sectors maintained a steady pace.

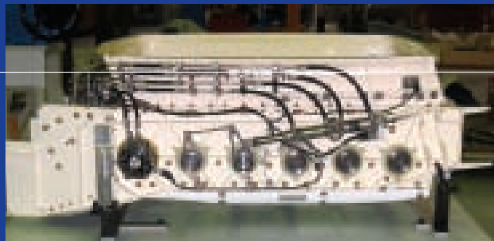
Magellan Aerospace began to experience the initial benefits of this strong marketplace in 2005, and also witnessed some of the less positive side effects that contributed to disappointing results at its bottom line. Earnings were low for the sales volume achieved, and reflect both legacy challenges and growth pains. Cost reduction activities undertaken in 2005 were offset by new program learning curve costs and the impact of foreign exchange as the

Canadian dollar continued to strengthen relative to other currencies. Pricing continued under pressure for much of 2005. Investments in equipment and training, required to increase production rates, raised operating costs and reduced returns. Additional costs were incurred to move from the technologies of current products to those of the future.

However, many encouraging signs of health in the aerospace industry were experienced in 2005, and many new opportunities for Magellan Aerospace developed. The aerospace market returned to buoyancy worldwide. In the civil airline sector, 2005 saw strong orders in the Pacific Rim, Asian and Middle Eastern regions, and emergence from bankruptcy protection of several North American Airlines. Record high load factors, initial fare increases, and fleet renewal decisions, such as those of Air Canada, are a basis for confidence in the sector. In defence, major new aerospace programs moved forward in Europe and North America, including ship borne and land-based helicopters, surveillance and fighter aircraft, transports and the engines that power them. Magellan's participation in major new programs was captured in 2005 in both civil and defence sectors, for engines, airplanes, helicopters and spacecraft. New programs bring new technology and new processes, improving the Company's ability to compete. These new revenue streams are long-term, enabling investments in efficiencies that will bring solid returns for many years, while development of supply sources in local and overseas areas over the past few years began to contribute to a better margin outlook.



Richard A. Neill
President and Chief Executive Officer



At the heart of the Magellan value added process are the unique manufacturing capabilities offered across the divisions. High velocity machining of all types of aerospace alloys transforms the raw material into finished product in a fraction of the time of conventional machining.

It's All In The Process

NON-METALLIC COMPOSITES ARE LAID UP AND ASSEMBLED FOR MANY STRUCTURAL APPLICATIONS. FORGING, CASTING AND BILLET MATERIAL IS MACHINED ON 5-AXIS COMPUTER NUMERICAL CONTROL MILLS AND LATHES, WHILE LARGER BILLETS ARE TRANSFORMED ON MULTI-SPINDLE GANTRY MILLS. VERTICAL INTEGRATION HAS ENABLED MAGELLAN TO PRODUCE FINISHED MACHINED ASSEMBLIES INCORPORATING ITS OWN SAND CASTINGS.

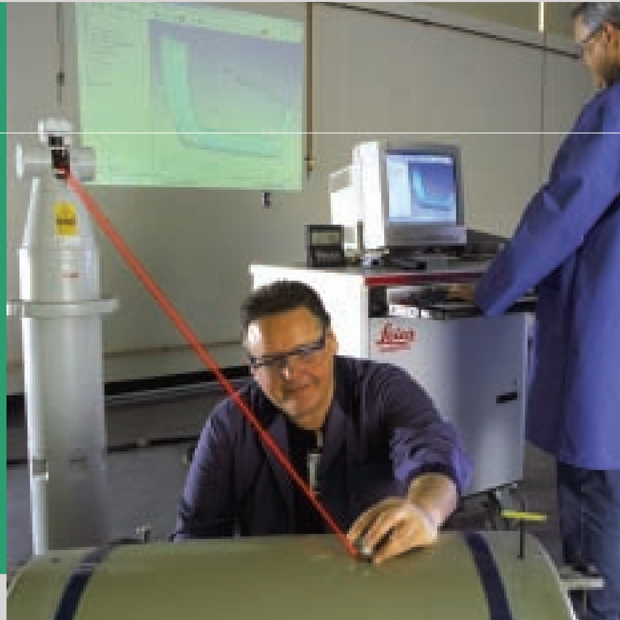
Realignment During 2005, Magellan worked to improve operations in all areas of the enterprise and to establish fair pricing that reflects current costs. The Company focused itself on re-aligning operations to achieve more efficiency, performance and return on investment. Starting from a corporate-wide industrial strategy, individual facilities began a process of change that is reducing excess capacity and increasing efficiencies. The process will result in smaller but more efficient plants, rationalization of technologies and products, use of supply chain capabilities, and acceptance of more complexity for in-house workload.

In the latter part of 2005, broad efforts were launched to adjust many of Magellan's long-term agreements to reflect current realities. This work is continuing into 2006, as the delicate balance of customer relationships and supplier profitability is found. Current realities, however, demand that the burden of major cost increases to suppliers

(material price increases, offloading of responsibilities and risk, stretched payments, etc.) is shared equitably. Foreign exchange shifts have had very significant impacts on profitability at Magellan's Canadian operations and on the consolidated revenue line for the Company. As the industry continues to ramp up, and supply tightens, this fact-based approach to correcting commercial terms is progressing well.

Global Market It became clear in 2005 that the recovery in the civil sector is universal, notwithstanding specific airlines or producers that are still early in the transition. What is also clear is that the upswing has come to the prime contractor (or Original Equipment Manufacturer – OEM) first, and has been slow to flow down to suppliers such as Magellan. This is caused in large part by two factors: the long slump in the industry that started in 2000/2001 left much of the supply base weakened and at various levels of impoverishment; secondly, the need to accept significant costs on behalf of the OEM and Tier One customers to participate in new program development is delaying improvements in the profitability of suppliers until program revenues exceed these costs. In spite of this lag effect, 2005 saw exciting new program introductions and advancements that bode well for suppliers, especially those able to contribute design engineering, superior technology, experienced supply management, and cost-effective production. Participation in these new programs deepens customer relationships, advances Magellan's technologies and processes, and refills the pipeline to succeed older programs currently in house.

THE MAGELLAN PROCESS OPERATES TO A CERTIFIED SYSTEM OF ISO9000, AS9100 AND NADCAP WHERE REQUIRED AND IS MANAGED IN AN ENVIRONMENT THAT VALUES CONTINUOUS IMPROVEMENT, LEAN MANUFACTURING AND HIGHLY CUSTOMER-FOCUSED PERFORMANCE.



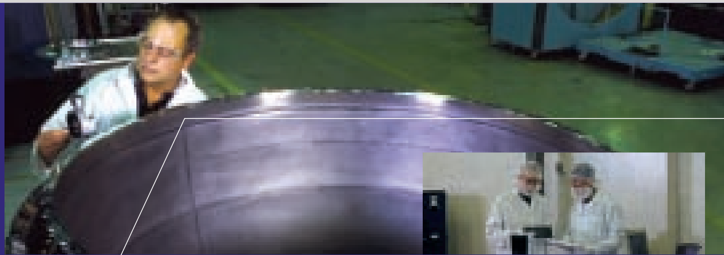
Technology Major changes are underway in the technologies within aerospace products, and within the processes used to design, manufacture and support these products. For companies such as Magellan, it's all in the process. As new materials are introduced to products, new manufacturing processes must be applied to derive a finished product. In aircraft structures, there is a much greater use of titanium and composites in place of aluminum. Engines are being designed with more titanium, magnesium and even composite to achieve higher performance at lower weight. Manufacturing processes rely on machining instead of fabrication, and automation instead of manual work. Protective coatings are applied through non-toxic flame-spray processes to achieve ecological requirements.

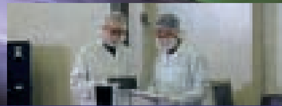
It's All In The Process

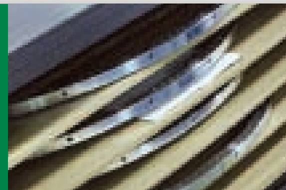
Magellan's product development process transforms the product design into manufacturing plans and tools utilizing sophisticated Computer Aided Design modeling and development software integrated with the customers' systems.

New Programs 2005 Magellan was successful in 2005 in capturing numerous large, new, long-term programs with both new and traditional customers. These awards include landing gear subassemblies and structural components for Boeing's newest jetliner, the B787, scheduled to fly in 2007, and large, main landing gear pistons on the world's largest airliner, the Airbus A380. Long-term renewal contracts were secured for wing ribs and other airframe components on the popular Airbus A320 and A330 aircraft. In the defence sector, major new opportunities were won on GE Aviation F414, F404, and J85 engines, and Lockheed Martin's F35 Joint Strike Fighter, which will first fly in late autumn 2006. Finally, Magellan's proprietary satellite buses and rocket motors received five contract awards over the course of 2005.

Whether in new manufacture or overhaul, the Magellan process integrates and manages the detail products required from the supply base through Enterprise Resource Planning and supply management systems to enable Magellan to deliver a fully integrated package to its customers.







Magellan's assembly process integrates many detailed parts from internal manufacturing and the global supply base into complex brazed and welded assemblies to produce a broad offering of high-level products.

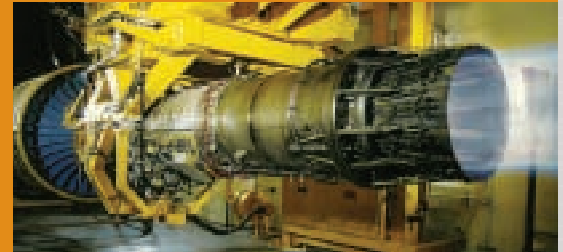
2005 HIGHLIGHT STATEMENT

In 2005, the aerospace market returned to buoyancy and improved profitability at the prime contractor level, with record orders for civil airliners and the launch of various new programs in both civil and defence sectors. The supply base, including Magellan Aerospace, lagged the primes, but also experienced a strong growth cycle, with new program investment, capital requirements, and training delaying immediate profitability improvements.

Message to shareholders

It's All In The Process

THE MAGELLAN PROCESS INCLUDES ALL FINAL TESTING REQUIREMENTS UP TO AND INCLUDING FULL ENGINE TESTING OF THE END PRODUCTS, ENABLING THE CUSTOMER TO INTEGRATE THEM DIRECTLY INTO THE FINAL PRODUCT.



2006 HIGHLIGHT STATEMENT

Many new programs are entering advanced stages of development and production in 2006, placing unprecedented demands and opportunities on the supply base. Integration of global supplier operations will accelerate, and alignment of internal and external activities will be required. Magellan Aerospace is confident in its ability to achieve growth in this market, and to produce results to meet the expectations of our customers, shareholders and employees.

Magellan Going Forward Looking forward to 2006 and beyond, these are exciting times in the aerospace world for a variety of reasons. A number of new products and projects that have been in the design and certification stage for some time are now entering production. Others that are in advanced development and will be flying for the first time in 2006 or 2007 will require the rollout of new and challenging manufacturing and management processes to enable full-scale production.

This will place demands on the supply chain in a way not seen before. The supply chain itself has been reinventing its processes, with big suppliers like Magellan undertaking large contracts over longer timeframes causing a need to restructure operations. Internal processes, which at one time were essentially self-contained and stand-alone, are being changed to recognize integration of operations on a global scale.

Changes in the supply chain mean that global sources are being incorporated into these plans and consequently, as internal processes are redesigned, this external supply base is integrated. All this is occurring while the drive to maintain quality and reliability continues; compliance with all airworthiness and other specifications is demanded; and cost improvement challenges are undertaken.

Magellan management is deeply involved in these strategic changes required to meet the challenges ahead, aligning internal functional activities and fully integrating external supply with internal operations.

On the regulatory side, Magellan is continually modifying its way of operating to adapt to the changes occurring in the financial, regulatory, and environmental requirements of a global business at a time when foreign exchange conditions have been volatile and at many times unpredictable.

The past three years the Company has adapted and worked hard to prepare for these times. We are confident that this dedicated effort will enable Magellan's growth and production of results that our customers, employees and shareholders expect.

N. Murray Edwards
Chairman
March 17, 2006

Richard A. Neill
President and Chief Executive Officer

The Management's Discussion and Analysis ("MD&A") has been prepared to provide a meaningful understanding of Magellan Aerospace Corporation's operations, performance and financial condition for the year ended December 31, 2005 and should be read in conjunction with the consolidated financial statements and notes as presented in the 2005 annual report. Magellan Aerospace Corporation ("Magellan" or the "Corporation") reports its audited consolidated financial statements in accordance with Canadian generally accepted accounting principles.

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 fact may be forward-looking statements. 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, the cost and competition throughout the aerospace industry in 2006 and the 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. The Corporation does not undertake to update any forward-looking information in this document whether as to new information, future events or otherwise.

The information contained herein is given as at March 17, 2006 unless otherwise denoted.

COMPANY OVERVIEW

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 military 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.

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 seeking growth in both aerospace and non-aerospace applications where these abilities are critical in meeting customer needs.

Magellan is organized and managed as a single business segment and is viewed as a single operating segment by the chief operating decision-makers, for the purpose of resource allocations, assessing performance, and strategic planning.

Within the single operating segment, the Corporation has two major product groupings: aerostructures and aeroengines. Aerostructure and aeroengine products are used both in new aircraft, and for spares and replacement parts. Within the aeroengines product grouping, the Corporation also performs repair and overhaul services for turbine engines and related components.

The Corporation serves both the commercial and defence markets. In 2005, 68% of sales were derived from the commercial markets (2004 – 65%, 2003 – 57%) while 32% of sales related to defence markets (2004 – 35%, 2003 – 43%).

SELECTED ANNUAL FINANCIAL INFORMATION

Expressed in $millions except per share information	2005	2004 (restated)	2003 (restated)
Revenues	568.5	573.8	478.3
Net loss for the year	(6.1)	(8.2)	(14.6)
Loss per common share			
Basic	(0.08)	(0.10)	(0.30)
Fully diluted	(0.08)	(0.10)	(0.30)
Total assets	713.9	724.5	752.1
Total long term financial liabilities	175.2	190.2	265.4

The Corporation has not paid dividends on its common shares in the past four years. In 2005, the Corporation issued 2,000,000 8.0% Cumulative Redeemable First Preference Shares Series A ("Preference Shares") and paid dividends thereon of $0.34 per share.

The commercial aerospace industry has endured a prolonged downturn that began in 2001. At that time, the overall North American economy had been slowing down to the point of recession. The collapse of the technology bubble and related stock market valuations, combined with the September 11, 2001 terrorist attacks in the US resulted in a significant and sudden decrease in the volume of air travel. Airlines responded to this decrease by deferring or cancelling deliveries of new commercial aircraft. Boeing's deliveries of large commercial aircraft (greater than 100 seats) fell from a total of 527 in 2001 to 281 in 2003. In the initial stages of the recovery in 2003, a number of external factors such as SARS, the Iraq war, and high fuel prices, delayed the industry recovery.

Actions taken by the Corporation to deal with the reduced revenues included a reduction in the workforce. While the Corporation took steps to minimize the cost of excess labour, this action also impacted the base over which manufacturing costs could be allocated to production. As a consequence, excess manufacturing overhead costs were expensed directly to cost of revenues, which significantly impacted margins. To minimize these charges in future periods, efforts have been undertaken to further reduce overhead costs while still maintaining core business capabilities to position the Corporation to participate as the industry recovers. In 2005, record amounts of orders were received by Boeing and Airbus, and as a result, demand for aerospace components should increase and continue at high rates for the foreseeable future.

During the first quarter of 2003, the Corporation announced its decision to cease operations at its Fleet Industries Ltd. plant in Fort Erie, Ontario. Management estimated the potential costs and losses resulting from this decision and recorded a charge to net earnings of $33.3 million. In 2004, the Corporation reached final agreements on ending customer programs and as a result, recorded an additional charge of $5.6 million to reflect additional costs of transferring and completing contractual obligations. Magellan's operations at this plant ceased late in 2005. In early 2006, the Corporation sold the manufacturing assets and leased the manufacturing facilities. While various costs remain to be fully settled, management believes the provision for closure previously recorded will be adequate to cover the remaining closure costs.

In 2003, the Corporation purchased the aerospace assets of Mayflower Aerospace in the United Kingdom, through its wholly owned subsidiary, Magellan Aerospace (UK) Limited ("MALUK"). MALUK produces structural components and performs engineering services, primarily for the commercial aerospace sector. Through MALUK, the Corporation gained significantly greater exposure to provide components on Airbus commercial aircraft. MALUK contributed revenues of $107.1 million in 2005.

A significant amount of the Corporation's revenues are denominated in US dollars. As the US dollar has declined in value over the past three years, the value of US dollar denominated revenues translated into Canadian dollars has also declined. If the Corporation's US dollar denominated revenues had been translated at the exchange rate in effect in 2002, revenues would have been approximately $115.0 million higher than the amount reported in 2005. This decline in the US dollar's value versus the Canadian dollar has diminished visibility of the underlying growth of the Corporation's business over the past three years. After adjusting for the exchange impact noted above, the Corporation's revenues have increased by approximately 48.0% over 2002 levels.

In late December 2003, Magellan entered into a revenue sharing agreement with GE Aviation to build the front and exhaust frames for the GE 414 engine. Deliveries on the exhaust frame commenced in 2004 and represented revenues of approximately $14.7 million in 2005. Revenues attributable to this contract are expected to increase by 50% in 2006 and reach a level of approximately $25.0 million per year once fully implemented in 2007.

On May 6, 2004 the Corporation announced the signing of a new supply agreement with Airbus UK, which represents additional work valued at approximately $24.0 million annually, across the full range of Airbus products with significant content on the Airbus A380. The work consists of complex machining of aluminium and hard metal alloys.

Along with the Airbus work, the Corporation has secured additional work from AugstaWestand and the GKN Group, representing approximately $10.0 million of additional annual revenue. In order to accommodate the expanded workload and to meet anticipated increases in volume on current contracts, Magellan acquired certain assets of Moores (Wallisdown) Limited, for a net purchase price of $10.4 million in the second quarter of 2004. These assets were located adjacent to existing MALUK facilities in the United Kingdom, and provided an opportunity to rationalize the increased workload across all divisions, reduce overhead costs and absorb the cost reduction demands that are now a feature of aerospace lean manufacturing.

The Corporation was awarded two significant new contracts in the past twelve months. On September 12, 2005 Magellan announced the signing of a new contract with Messier-Dowty to build landing gear components for the Boeing 787 Dreamliner aircraft. The contract is worth an estimated US $90.0 million over the initial contract period with deliveries commencing in 2006. On February 16, 2006 Magellan announced the signing of a new contract with Goodrich Corporation to manufacture pistons for the main and wing landing gear for the Airbus A380 aircraft. This contract is worth an estimated $150.0 million over the initial 10 year period, with deliveries commencing in the second quarter of 2006.

The Corporation successfully reached labour agreements with unionized employees at three of its facilities in 2005, resulting in three-year agreements in each instance. One agreement at another facility expired in early 2006. Subsequent to such expiry the Corporation reached a new three-year agreement with its employees at such operation.

RESULTS FROM OPERATIONS

Revenues

	Twelve-months ended December 31		
Expressed in $thousands	**2005**	2004	Change
Canada	**277,530**	287,613	-3.5%
United States	**183,811**	185,591	-1.0%
United Kingdom	**107,142**	100,575	6.5%
Total Revenues	**568,483**	573,779	-0.9%

Consolidated revenues for the year ended December 31, 2005 were $568.5 million, a decrease of $5.3 million or 0.9% over the previous year. The decline in value of the US dollar versus the Canadian dollar in 2005 had a negative impact on revenue. Because a significant percentage of Magellan's revenues are denominated in US dollars, revenues were approximately $36.6 million lower than if the average exchange rate experienced in 2004 had remained constant in 2005. In addition, the shutdown of the Corporation's Fort Erie location reduced consolidated revenues by $12.7 million. If these factors are taken into account, consolidated revenues grew in 2005 by approximately 7.7% over 2004.

Results from Operations (cont'd)

Gross Profit

Expressed in $thousands	Twelve-months ended December 31 2005	2004	Change
Gross profit	**56,450**	58,960	-4.3%
Percentage of revenue	**9.9%**	10.3%	

Gross profit in 2005 was $56.5 million, a decrease of $2.5 million from 2004. As a percentage of revenue, gross profit was 9.9% of sales in 2005 compared to 10.3% of sales in 2004. The increasing value of the Canadian dollar as compared to the US dollar had a significant negative impact on gross margin. While the Corporation has a hedging program in place to protect its profitability, hedged levels were not as advantageous as they were in 2004. The net effect of the foreign exchange rates was a reduction in gross profit of approximately $7.0 million in 2005 over 2004 levels. The Corporation had expected operational efficiencies to improve at several manufacturing facilities where demand had begun to increase significantly. This improvement in efficiencies did not occur in 2005, and the Corporation has taken steps to improve manufacturing techniques, and implement other cost reduction initiatives. It is also increasing its low-cost sourcing activities to improve the gross profit.

Administrative and General Expenses

Expressed in $thousands	Twelve-months ended December 31 2005	2004 (restated)
Administrative and general expenses	**46,110**	46,747
Gain on sale of capital assets	**(1,442)**	(2,026)
Foreign exchange gain	**(1,624)**	(3,914)
Total administrative and general expenses	**43,044**	40,807
Percentage of revenues	**7.6%**	7.1%

Administrative and general expenses for 2005 were $43.0 million, compared to $40.8 million in 2004. Included in administrative and general expenses is a foreign exchange gain, resulting from the change in foreign exchange rates on the Corporation's US denominated working capital balances and debt in Canada, of $1.6 million in 2005 versus a gain of $3.9 million in 2004. In addition, administrative and general expenses also contain gains on the sale of capital assets of $1.4 million in 2005 and $2.0 million in 2004. Excluding these gains, administrative and general expenses were 8.1% of revenues in 2005, compared to 8.1% in 2004.

Interest Expense

Expressed in $thousands	Twelve-months ended December 31 2005	2004 (restated)
Interest on bank indebtedness and long-term debt	**11,172**	13,635
Convertible debenture interest	**5,950**	5,950
Accretion charge for convertible debt	**2,211**	2,136
Discount on sale of accounts receivable	**2,201**	1,896
Total interest expense	**21,534**	23,617

Interest costs for 2005 were $21.5 million, a decrease of $2.1 million from 2004. Interest costs are lower in 2005 compared to 2004 because of lower interest rates (see note 7 to the Consolidated Financial Statements). During the year, the Corporation sold $287.4 million of accounts receivable at a discount of $2.2 million, which represented an annualized interest rate of 5.16%. This discount was included in interest expense. In 2004, $177.3 million of receivables were sold at a discount of $1.9 million.

Provision for (Recovery of) Income Taxes

Expressed in $thousands	Twelve-months ended December 31 2005	2004 (restated)
Provision for current income taxes	**688**	780
Recovery of future income taxes	**(2,740)**	(3,696)
Total (recovery of) provision for income taxes	**(2,052)**	(2,916)
Effective Tax Rate	**25.2%**	26.3%

The Corporation recorded a provision for the recovery of income taxes in 2005 of $2.1 million on a pre-tax loss of $8.1 million, representing an effective tax rate of 25.2%, compared to a recovery of income taxes of $2.9 million on a pre-tax loss of $11.1 million in 2004 for an effective tax rate of 26.3%. The effective rate of recovery is lower than the expected rate of 37.5% because of non-deductible accretion charges that relate to the convertible debenture and stock option charges.

Cash Flow from Operating Activities

Expressed in $thousands	Twelve-months ended December 31 2005	2004
Decrease in accounts receivable	**5,009**	18,323
(Increase) decrease in inventories	**(5,736)**	2,750
Increase in prepaid expenses and other	**(1,756)**	(1,145)
Increase (decrease) in accounts payable	**436**	(9,653)
Net change in non-cash working capital items	**(2,047)**	10,275
Cash provided by operating activities	**14,568**	28,941

For the year ended December 31, 2005, Magellan generated cash flow of $14.6 million from operations. Non-cash charges for depreciation and cash generated by a reduction in accounts receivable offset the net loss for the year as well as cash used to reduce accounts payable and accruals.

Cash Flow from Investing Activities

Expressed in $thousands	Twelve-months ended December 31 2005	2004
Business acquisition	**–**	(10,440)
Purchase of capital assets	**(19,185)**	(16,936)
Proceeds from disposals of capital assets	**3,746**	17,089
(Increase) decrease in other assets	**(7,435)**	15
Cash used in investing activities	**(22,874)**	(10,272)

The Corporation invested $19.2 million in capital assets during the year, to upgrade its machinery and facilities, an increase of $2.3 million from 2004. Magellan has cautiously increased the level of capital expenditures to address the growing demand from its customers.

SUMMARY OF QUARTERLY RESULTS

Expressed in $millions except per share information	2005				2004 (restated)			
	March 31	**June 30**	**Sept 30**	**Dec 31**	March 31	June 30	Sept 30	Dec 31
Revenues	**144.9**	**146.2**	**134.6**	**142.8**	136.0	157.8	142.7	137.3
Net loss	**(1.7)**	**(0.3)**	**(0.6)**	**(3.5)**	1.1	(3.4)	0.5	(6.4)
(Loss) income per common share								
Basic	**(0.02)**	**(0.00)**	**(0.01)**	**(0.05)**	0.01	(0.04)	0.00	(0.07)
Fully diluted	**(0.02)**	**(0.00)**	**(0.01)**	**(0.05)**	0.01	(0.04)	0.00	(0.07)

The decline in value of the US dollar verses the Canadian dollar significantly impacted the valuation of revenues on a quarterly basis. Had exchange rates remained at levels experienced in each quarter of 2004, revenues in 2005 would have been higher by approximately $8.0 million in the first quarter, approximately $10.3 million in the second quarter, approximately $10.5 million in the third quarter, and approximately $7.4 million in the fourth quarter.

LIQUIDITY

Contractual Obligations

		Payments due by period			
Expressed in $thousands	Total	Less than 1 year	1-3 Years	4-5 Years	After 5 Years
Long-Term Debt	6,013	1,102	1,266	1,626	2,019
Capital Lease Obligations	5,796	1,099	2,024	1,464	1,209
Operating Leases	17,044	4,823	8,680	2,826	715
Other Long-Term Liabilities	38,195	23,134	10,244	3,394	1,423
Total Contractual Obligations	**67,048**	**30,158**	**22,214**	**9,310**	**5,366**

Major cash flow requirements for 2006 include capital lease principal payments of $1.5 million, payments of other liabilities of $23.1 million and operating leases of $4.8 million. The Corporation believes that these amounts will be financed through operating cash flows and existing credit facilities.

The Corporation has made contractual commitments to purchase $6.2 million of capital assets. The Corporation also has purchase commitments, largely for materials, in 2006, made through the normal course of operations, of $148.6 million. The Corporation plans to finance these commitments with operating cash flow and its existing credit facility.

OFF BALANCE SHEET ARRANGEMENTS

The Corporation has entered into arrangements in which it sold certain accounts receivable to third parties at a discount. This discount typically represents approximately 1.0% to 2.0% over 60 day BA or LIBOR rates. At December 31, 2005, the amount of receivables sold to third parties that remained outstanding was $42.5 million. A reserve of $7.7 million is included within accounts receivable that represents the maximum recourse to the third parties.

The Corporation uses derivative financial instruments to manage foreign exchange risk. The Corporation does not trade in derivatives for speculative purposes.

The Corporation has entered into foreign exchange contracts to hedge certain future cash flows in US dollars. Under these contracts the Corporation may be obliged to purchase or sell specific amounts of US dollars at predetermined dates and exchange rates. These contracts are matched with anticipated operational cash flows in US dollars.

The Corporation had US dollar exchange contracts outstanding at December 31, as follows:

	2005	
	Amount	Exchange rate
Maturity – less than 1 year	$ 8,500	1.1665

RELATED PARTY TRANSACTIONS

The Chairman of the Board of the Corporation holds $15.0 million of the $70.0 million of convertible debentures issued in 2003. The related cash interest for the year was $1.3 million (2004 – $1.3 million).

The Chairman of the Board of the Corporation has also guaranteed the amounts drawn under the Corporation's bank operating credit and is paid an annual fee of $0.2 million (0.1% of the guarantee value) as compensation for this guarantee.

During the year, the Corporation sold accounts receivable totaling $15.1 million to a company with a common director, for a discount of $0.1 million.

CRITICAL ACCOUNTING ESTIMATES

Cost of Sales

Average unit cost for products produced under long-term contracts is determined based on the estimated total production costs for a predetermined program quantity. Program quantities are established based on management's assessment of market conditions and foreseeable demand at the beginning of the production stage for each program, taking into consideration both customer supplied and independent data. The average unit cost is recorded to cost of sales as products are completed. Under the learning curve concept, which anticipates a predictable decrease in unit costs as tasks and production techniques become more efficient through repetition and management action, excess over average production costs during the early stages of a program are deferred and recovered from sales of products anticipated to be produced later at lower-than-average costs.

Estimates of average unit production costs and of program quantities are an integral component of average cost accounting. Management conducts regular reviews as well as a detailed annual review in the fourth quarter, as part of its annual budget process, of its cost estimates and program quantities, and the effect of any revisions are accounted for by way of a cumulative catch-up adjustment to income in the period in which the revision takes place.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Corporation has utilized financial instruments to hedge its exposure to foreign currency flows. A gain of $4.1 million (2004 – $6.0 million) was realized during the year on settlement of these instruments.

CHANGE IN ACCOUNTING POLICY

The principal amount of the Corporation's outstanding convertible debentures of $70.0 million due on January 31, 2008 was previously classified as an equity instrument due to the Corporation's ability to settle principal and interest payments by the issuance of common shares. In accordance with the amended standard CICA 3860, the Corporation has presented the liability component of its convertible debentures as long-term debt and the equity component as additional paid-in capital. The liability represents the present value of the principal payment of the debentures and the equity component represents the fair value of the holder's conversion feature. The stated interest payments and accretion expense from adjusting the value of the principal of the debentures over time are recorded as interest expense in the statement of operations.

RISK FACTORS

The Corporation's performance may be affected by a number of risks and uncertainties. Magellan's senior management identifies key risks and has processes in place to monitor, manage, and mitigate these risks. Additional risks and uncertainties not presently known by the Corporation, or that the Corporation does not currently anticipate will be material may impair the Corporation's performance.

Factors that have an adverse impact on the aerospace industry may adversely affect the Corporation's results of operations.

The majority of the Corporation's gross profit and operating income is derived from the aerospace industry. The Corporation's aerospace operations are focused on engineering and manufacturing aircraft components on new aircraft, selling spare parts and performing repair and overhaul services on existing aircraft and aircraft components. Therefore, the Corporation's business is directly affected by economic factors and other trends that affect the Corporation's customers in the aerospace industry, including a possible decrease in outsourcing by aircraft operators and original equipment manufactures ("OEMs"), decreased demand for air travel or projected market growth that may not materialize or be sustainable. When these economic and other factors adversely affect the aerospace industry, they tend to reduce the overall customer demand for the Corporation's products and services, which decreases the Corporation's operating income. Economic and other factors, both internal to the aerospace industry or general economic factors that might affect the aerospace industry may have an adverse impact on the Corporation's results of operations.

Fluctuations in the value of foreign currencies could result in currency exchange losses.

A portion of the Corporation's revenues and expenses are not currently denominated in Canadian dollars, and it is expected that some revenues and expenses will continue to be based in currencies other than the Canadian dollar. Therefore, fluctuations in the Canadian dollar exchange rate will impact the Corporation's results of operations and financial condition from period to period. In addition, such fluctuations affect the translation of the Corporation's results for purposes of its consolidated financial statements. The Corporation's currency hedging activities may not be successful.

The Corporation may be adversely impacted by its level of indebtedness.

The Corporation and its subsidiaries have significant debt obligations. The degree to which this indebtedness could have consequences on the Corporation's prospects include the effect of such debts on the ability to obtain additional financing for working capital, capital expenditures or acquisitions, the portion of available cash flow that will need to be dedicated to repayment of principal and interest on indebtedness, thereby reducing funds available for expansion and operations and the Corporation's vulnerability to economic downturn and its ability to withstand competitive pressure. If the Corporation is unable to meet its debt obligations, it may need to consider refinancing or adopting alternative strategies to reduce or delay capital expenditures, selling assets or seeking additional equity capital.

The agreements with labour unions representing certain of the Corporation's employees are subject to renewal.

The Corporation is party to collective bargaining agreements throughout its business which are subject to expiration at various times in the future. During 2006 a labour agreement at Haley Industries Limited expired and was renewed with no material impact to operations. If the Corporation is unable to renew other agreements as they become subject to renegotiation from time to time, it could result in work stoppages and other labour disturbances which could have a material adverse effect on its business. This risk may be mitigated by the ability of the Corporation to transfer work from one location to another.

The loss of one of the Corporation's key customers could have a material adverse effect on the Corporation.

For the period ended December 31, 2005, direct sales to The Boeing Company represented approximately 15.5% of net sales and is expected to remain at approximately the same level of net sales in 2006. In 2005, direct sales to Airbus represented approximately 15.0% of net sales and this is expected to remain at approximately the same level of net sales in 2006. The loss of either of these customers or any significant decline in purchasing by either customer from the Corporation could have a material adverse impact on the Corporation.

Customer unit deliveries may not reach the number projected when the basis for amortization of non-recurring costs is established.

The Corporation relies on customers' delivery projections to determine the number of units over which to amortize non-recurring costs. Should deliveries not reach the number projected, any unamortized balance that remains would then need to be written off which could have a material adverse impact on the Corporation.

Bank Facility Commitments and Financial Condition.

The Corporation's operating facility expires on May 26, 2006 but is extendable to May 26, 2007. This credit facility is fully guaranteed by Mr. Edwards, a director and Chairman of the Corporation. The Corporation is currently discussing the extension of this facility with its lenders and expects to renew this facility in the second quarter of 2006. There is no assurance that the Corporation will be successful in renewing the facility or securing alternate financing or that further refinancing of bank indebtedness may not be necessary in the future. There is also no assurance that Mr. Edward's guarantee, if required, will be available beyond the term of the current commitment. Although Magellan expects to be able to negotiate covenants it expects to achieve, there is no assurance that Magellan will be in compliance with all of its bank covenants at all times during the upcoming twelve months due to unforeseen events or circumstances, some of which are outlined in this section "*Risk Factors*".

A reduction in defence spending by the United States or other countries could result in a decrease in revenue.

The Corporation relies on sales to military customers particularly in the United States. A significant reduction in military expenditures by the United States or other countries with which the Corporation has contracts could materially adversely affect the Corporation's business and financial condition. The loss or significant reduction in government funding of a large program in which the Corporation participates could also materially adversely affect sales and earnings.

Competitive pressures may adversely affect the Corporation.

The Corporation competes in the aerospace industry primarily with OEMs and the manufacturers that supply them, some of which are divisions or subsidiaries of OEMs, and other large companies that manufacture aircraft components and subassemblies. Competition for the repair and overhaul of aerospace components comes from three primary sources: OEMs, major commercial airlines and other independent repair and overhaul companies. Some of the competitors' financial and other resources are substantially greater than the Corporation's. Competitive pressures may materially adversely affect the Corporation's operating revenues and, in turn, the Corporation's business and financial condition.

The Corporation may need to expend significant capital to keep pace with technological developments in its industry.

The aerospace industry is constantly undergoing development and change and it is likely that new products, equipment and methods of repair and overhaul service will be introduced in the future. In order to keep pace with any new developments, the Corporation may need to expend significant capital to purchase new equipment and machines or to train the Corporation's employees in the new methods of production and service. In addition, the Corporation makes significant expenditures for the research and development of new products and services. The Corporation may not be successful in developing new products and these capital expenditures may have a material adverse effect on the Corporation.

The Corporation may incur significant expenses to comply with new or more stringent governmental regulation.

The aerospace industry is highly regulated in most countries by specialized government agencies. The Corporation must be certified in such jurisdictions and, in some cases, by individual OEMs in order to engineer and service parts and components used in specific aircraft models. If any of the Corporation's material authorizations or approvals were revoked or suspended, the Corporation's operations would be adversely affected. Although it is not expected, new or more stringent governmental regulations may be adopted, or industry oversight heightened, in the future, and the Corporation may incur significant expenses to comply with any new regulations or any heightened industry oversight.

The Corporation may be unable to successfully achieve "key supplier" status with OEMs, and may be required to risk capital to achieve key supplier status.

Many OEMs are moving toward developing strategic partnerships with their key suppliers. Each key supplier provides an array of integrated services including purchasing, warehousing and assembly for OEM customers. The Corporation has been designated as a key supplier by some OEMs and is striving to achieve a higher level of integrated supply with other OEMS. In order to achieve key status, the Corporation may need to expand the Corporation's existing capacities or capabilities, and there is no assurance that the Corporation will be able to do so.

Risk Factors (cont'd)

Many new aircraft and aircraft engine programs require that major suppliers become risk-sharing partners, meaning that the cost of design, development and engineering work associated with the development of the aircraft or the aircraft engine is partially born by the supplier, usually in exchange for a life-time agreement to supply those critical parts once the aircraft or the aircraft engine is in production. In the event that the aircraft or the aircraft engine fails to reach the production stage, inadequate number of units is produced, or actual sales otherwise do not meet projections, the Corporation may incur significant costs without any corresponding revenues.

The Corporation may not realize the Corporation's anticipated return on capital commitments made to expand its capabilities.

From time to time, the Corporation makes significant capital expenditures to implement new processes and to increase both efficiency and capacity. Some of these projects require additional training for the Corporation's employees and not all projects may be implemented as anticipated. If any of these projects do not achieve the anticipated increase in efficiency or capacity, the Corporation's returns on these capital expenditures may not be as expected.

Most of the Corporation's contracts are subject to competitive bidding. If the Corporation is unable to successfully compete in the bidding process, the Corporation's results of operations could suffer.

The Corporation obtains most of its contracts through a competitive bidding process that subjects it to the risk that it will expend substantial time and effort on the design, development and marketing of proposals for contracts that may not be awarded to it. The Corporation is sometimes required to bid on programs in advance of the completion of the prime vehicle or system design. This creates a risk that it will experience unforeseen technological difficulties and cost overruns. The Corporation cannot ensure that it will continue to win competitively awarded contracts at the same rate as in the past.

The Corporation may not be able to successfully negotiate long-term contracts to eliminate losses.

From time to time circumstances under which long-term contracts are negotiated change and require amendments so the Corporation does not incur a loss. At December 31, 2005 Magellan was in negotiation with one of its customers over material amendments to pricing with respect to existing long-term contracts. If these negotiations or future negotiations on other contract negotiations are not successful or the final terms are different from what the Corporation expects, the Corporation may be required to record a loss provision on these contracts which will be materially adverse to the Corporation. The amount of such provision, if any, cannot be reasonably estimated until such amendments are finalized.

The Corporation may be affected by interest rate fluctuations.

The Corporation's operations have been significantly financed by debt, and it has significant debt obligations. The majority of the Corporation's interest bearing long-term debt bore a variable interest rate. Consequently, the Corporation is sensitive to fluctuations in interest rates. Interest rate risk is generally managed by maintaining a balance between long and short-term exposure, which the Corporation believes provides the best effective cost for the level of exposure management deems appropriate.

The Corporation may need additional financing for acquisitions and capital expenditures and additional financing may not be available on acceptable terms.

A key element of the Corporation's strategy has been, and continues to be, internal growth and growth through the acquisition of additional companies and product lines engaged in the aerospace industry. In order to grow internally, the Corporation may need to make significant capital expenditures and may need additional capital to do so. The Corporation's ability to grow is dependent upon, and may be limited by, among other things, availability under the credit facilities and by particular restrictions contained therein and the Corporation's other financing arrangements. In that case, additional funding sources may be needed, and the Corporation may not be able to obtain the additional capital necessary to pursue its internal growth and acquisition strategy or, if the Corporation can obtain additional financing, the additional financing may not be on financial terms which are satisfactory to it.

Cancellations, reductions or delays in customer orders may adversely affect the Corporation's results of operations.

The Corporation's overall operating results are affected by many factors, including the timing of orders from large customers and the timing of expenditures to manufacture parts and purchase inventory in anticipation of future sales of products and services. A large portion of the Corporation's operating expenses is relatively fixed. Because several of the Corporation's operating locations typically do not obtain long-term purchase orders or commitments from customers, the Corporation must anticipate the future volume of orders based upon the historic purchasing patterns of customers and upon discussions with

customers as to their anticipated future requirements. These historic patterns may be disrupted by many factors, including changing economic conditions, inventory adjustments, work stoppages or labour disruptions, cancellations, reductions or delays in orders by a customer or group of customers could have a material adverse effect on the Corporation's business, financial condition and results of operations.

Any exposure to environmental liabilities may adversely affect the Corporation.

The Corporation's business, operations and facilities are subject to numerous stringent federal, provincial, state, local and foreign environmental laws and regulations. In Canada, the Corporation is required to maintain Certificates of Approval with respect to its water discharge, air emissions and land fill sites. The provincial Ministry of Environment in each province conducts periodic compliance reviews, and the Corporation is required to perform ongoing tests of its discharges. From time to time due to noncompliance matters which arise, remediation and containment orders are received which require action by the Corporation. The Corporation commits financial and technical resources as it deems necessary, including outside consultants, to develop action plans in accordance with the requirements of the various jurisdictions within which it operates. The regulatory authorities and the Corporation have agreed on a remediation plan for the former Fleet Industries site. While it is expected that the remediation plan will be successful the plan incorporates a new technique which may not be successful within the time and budget contemplated. Although management believes that the Corporation's operations and facilities are in material compliance with such laws and regulations, future changes in these laws, regulations or interpretations thereof or the nature of the Corporation's operations may require the Corporation to make significant additional capital expenditures to ensure compliance in the future.

In December 2002 the Government of Canada ratified the Kyoto Protocol and it became legally binding on February 16, 2005. This protocol calls for Canada to reduce its greenhouse gas emissions to 6 percent below 1990 levels during the period between 2008 and 2012. Details of specific requirements relating to the aerospace industry have not been enacted and accordingly the impact of the Kyoto Protocol is unknown.

CONTROLS AND PROCEDURES

Based on the current Canadian Securities Administrators (CSA) rules under Mulltilateral Instrument 52-109, the Chief Executive Officer and Chief Finance Officer (or performs similar functions as a chief executive officer or chief finance officer) will be required to certify as at December 31, 2005 that they have designed and assessed the effectiveness of disclosure controls and procedures.

In preparation for this certification, the Corporation has dedicated resources in place to document disclosure controls and procedures and evaluate its design and operating effectiveness. As of December 31, 2005, an evaluation was performed under the supervision and with participation of Magellan's management, including the President and Chief Executive Officer and Vice-President, Finance and Corporate Secretary, of the effectiveness of Magellan's disclosure controls and procedures, as defined in the rules of the CSA. Based on that evaluation, Magellan's management concluded that Magellan's disclosure controls and procedures were effective at a reasonable assurance level as of December 31, 2005.

OTHER 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 March 17, 2006, 90,795,406 common shares were outstanding and 2,000,000 Preference Shares were outstanding.

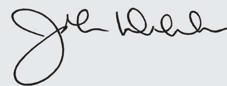
The Corporation has outstanding $70.0 million of 8.5% convertible unsecured subordinated debentures, due January 31, 2008. The debentures are convertible at any time prior to the maturity date by holders into common shares of the Corporation at a conversion price of $4.50 per common share. Full conversion of the convertible debentures would give rise to an additional 15,555,556 common shares.

Additional information relating to Magellan Aerospace Corporation, including the Corporation's Annual Information Form is on SEDAR at www.sedar.com.

The consolidated financial statements of **Magellan Aerospace Corporation** were prepared by management in accordance with accounting principles generally accepted in Canada. The financial and operating information presented in this report is consistent with that shown in the financial statements.

Management maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

External auditors appointed by the shareholders have examined the consolidated financial statements. The Audit Committee, consisting of non-management directors, has reviewed these consolidated financial statements with management and the auditors and has reported to the Board of Directors. The Board approved the consolidated financial statements.



Richard A. Neill
President and Chief Executive Officer

John B. Dekker
Vice President Finance and Corporate Secretary

March 17, 2006.

Auditors' Report

TO THE SHAREHOLDERS OF MAGELLAN AEROSPACE CORPORATION

We have audited the consolidated balance sheets of **Magellan Aerospace Corporation** as at December 31, 2005 and 2004 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Toronto, Canada,
February 17, 2006.

Consolidated Balance Sheets

[Expressed in thousands of dollars] As at December 31	2005	2004 (restated note 2)
ASSETS		
Current		
Cash	$ 7,426	$ 9,048
Accounts receivable [note 14[f]]	62,862	70,974
Inventories [note 5]	268,590	269,735
Prepaid expenses and other	9,343	8,113
Future income tax assets [note 15]	3,518	7,104
Total current assets	351,739	364,974
Capital assets, net [note 6]	264,899	274,724
Other [note 14[g]]	46,467	42,486
Future income tax assets [note 15]	50,752	42,318
	$ 713,857	$ 724,502
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness [note 7]	$ 113,824	$ 68,028
Accounts payable and accrued charges [note 8]	122,978	114,327
Current portion of long-term debt [note 9]	2,201	48,335
Total current liabilities	239,003	230,690
Long-term debt [note 9]	9,608	11,856
Convertible debentures [note 10]	65,141	63,042
Future income tax liabilities [note 15]	77,301	82,345
Other long-term liabilities [note 8]	15,061	32,926
Shareholders' equity		
Capital stock [notes 11 and 12]	234,058	213,962
Contributed surplus [note 14[h]]	854	234
Other paid in capital [note 10]	11,100	11,100
Retained earnings	107,019	114,175
Foreign exchange translation [note 13]	(45,288)	(35,828)
Total shareholders' equity	307,743	303,643
	$ 713,857	$ 724,502

See accompanying notes

On behalf of the Board:

N. Murray Edwards
Director

William A. Dimma
Director

Magellan Aerospace Corporation

Consolidated Statements of Operations and Retained Earnings

[Expressed in thousands of dollars except per share data] Years ended December 31	2005	2004 (restated note 2)
Revenues	**$ 568,483**	$ 573,779
Cost of revenues	**512,033**	514,819
Gross profit	**56,450**	58,960
Expenses		
Administrative and general expenses	**43,044**	40,807
Interest [notes 14[a] and [d]]	**21,534**	23,617
Unusual items [note 4]	**–**	5,616
	64,578	70,040
Loss before income taxes	**(8,128)**	(11,080)
Provision for (recovery of) income taxes [note 15]		
Current	**688**	780
Future	**(2,740)**	(3,696)
	(2,052)	(2,916)
Net loss for the year	**$ (6,076)**	$ (8,164)
Retained earnings, beginning of year	**$ 114,175**	$ 122,339
Dividends on Preference Shares	**(1,080)**	–
Net loss for the year	**(6,076)**	(8,164)
Retained earnings, end of year	**$ 107,019**	$ 114,175
Loss per common share [note 11]		
Basic	**$ (0.08)**	$ (0.10)
Diluted	**$ (0.08)**	$ (0.10)

See accompanying notes

Consolidated Statements of Cash Flows

[Expressed in thousands of dollars] Years ended December 31	2005	2004 (restated note 2)
OPERATING ACTIVITIES		
Net loss for the year	$ (6,076)	$ (8,164)
Add (deduct) items not affecting cash		
Depreciation and amortization	24,042	24,481
Gain on sale of capital assets	(1,442)	(2,026)
Unusual item	–	5,616
Stock based compensation	620	234
Accretion of convertible debentures	2,211	2,136
Future income taxes recoveries	(2,740)	(3,611)
	16,615	18,666
Net change in non-cash working capital items related to operating activities [note 14[c]]	(2,047)	10,275
Cash provided by operating activities	14,568	28,941
INVESTING ACTIVITIES		
Acquisition [note 3]	–	(10,440)
Purchase of capital assets	(19,185)	(16,936)
Proceeds from disposal of capital assets	3,746	17,089
(Increase) decrease in other assets	(7,435)	15
Cash used in investing activities	(22,874)	(10,272)
FINANCING ACTIVITIES		
Increase in bank indebtedness	50,826	250
Repayment of long-term debt	(50,276)	(33,687)
Decrease in other long-term liabilities	(12,480)	(11,402)
Issuance of Common Shares	147	31,229
Issuance of Preference Shares	19,949	–
Dividends on Preference Shares	(1,080)	–
Cash provided by (used in) financing activities	7,086	(13,610)
Effect of exchange rate changes on cash	(402)	101
Net (decrease) increase in cash during the year	(1,622)	5,160
Cash, beginning of year	9,048	3,888
Cash, end of year	$ 7,426	$ 9,048

See accompanying notes

[Expressed in thousands of dollars except share and per share data] December 31, 2005 and 2004

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles within the framework of the significant accounting policies summarized below. The consolidated financial statements of Magellan Aerospace Corporation [the "Corporation"] include the accounts of the Corporation and its wholly-owned subsidiaries.

Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect: the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amount of revenue and expenses during the reporting period. Management believes that the estimates included in preparing its consolidated financial statements are reasonable and prudent; however, actual results could differ from these estimates.

Revenue recognition

Revenue from the sale of manufactured units is recognized when the price is fixed or determinable, collectibility is reasonably assured and upon shipment to, or receipt by, customers, depending on contractual terms, and acceptance by customers.

Revenues from long-term contracts are recognized on a percentage of completion basis. Where it is expected that a loss will be incurred on completion of a contract, a provision is made for the total estimated loss.

Inventories

Inventories, which are primarily attributable to long-term contracts, are stated at the lower of cost and estimated net realizable value. As the operating cycles for long-term contacts are longer than one year these inventories are included in current assets.

Inventoried costs on long-term contracts include pre-production costs consisting primarily of engineering costs, including applicable overhead, and other development costs, provided that their recovery can be regarded as reasonably assured. In the early stages of a long-term contract, a constant gross margin is achieved by continuing to defer in inventory a portion of the actual costs for each unit delivered. This excess over average production costs is recovered from sales of units anticipated to be produced at lower-than-average costs, as a result of the learning curve concept, which anticipates a predictable decrease in unit costs as tasks and production techniques become more efficient through repetition and management action.

Estimates of revenues, unit production costs and delivery periods associated with forecasted orders are an integral component of the learning curve concept, and management's ability to reasonably estimate these amounts is a requirement for the use of the learning curve concept. Management periodically reviews its assumptions as to the size of the various programs, the estimated period over which the units will be delivered and the estimated future costs and revenues associated with the programs. Adjustments of estimates are accounted for prospectively with the exception of anticipated losses on specific programs, which are recognized immediately in the period when losses are anticipated.

Advances and progress billings received on long-term contracts are deducted from related costs in inventories. Advances and progress billings in excess of related costs are classified as deferred revenue.

1. Significant Accounting Policies (cont'd)

Capital assets

Capital assets are recorded at cost less related government grants and investment tax credits and are depreciated over their estimated useful lives, with a 10% residual value, as follows:

Buildings	40 years
Machinery and equipment	20 years

Impairment of long-lived assets

The Corporation assesses long-lived assets for recoverability whenever indicators of impairment exist. If the carrying value of the asset exceeds the estimated undiscounted cash flows from use of the asset, an impairment loss is recognized. Impairment losses are measured as the amount by which the asset's carrying value exceeds its fair value. Fair value is based on discounted cash flows.

Technology rights

Included in other assets are the costs to purchase technological rights applicable to a specific long-term contract. These costs will be amortized on a units of production basis to cost of goods sold over the anticipated term of the long-term contract.

Research and development

Research and development costs are charged to operations as incurred, due to the nature of the projects. Where government incentives in the form of investment tax credits and grants are received for research and development projects initiated by the Corporation for its own purposes, these incentives are deducted from the applicable category of expenditures, that is, either cost of revenues, capital assets or research and development costs.

Government investment

The Corporation makes periodic applications for government investment under available government programs, including investment tax credits. Government investment relating to capitalized expenditures is reflected as a reduction of the related costs of such assets. Government investment relating to operating expenses is recorded as a reduction of the related expenses as incurred.

Convertible debentures

The amount recorded as convertible debentures includes the present value of the future interest and principal amounts of the debentures. The amount will be accreted to the face value of the convertible debentures over the term to maturity through periodic charges to income.

The value of the holder's option to convert the convertible debentures into common shares of the Corporation is recorded as other paid in capital. The holder's conversion option is valued using the residual value approach.

Foreign exchange translation

Monetary assets and liabilities of the Corporation denominated in foreign currencies are translated at the year-end exchange rates. Revenue and expenses are translated at actual rates of exchange when the transaction occurred. Exchange gains and losses on these items are recognized in income in the current year.

The Corporation's operations outside of Canada are considered self-sustaining. Consequently, the assets and liabilities are translated to Canadian dollars using the year-end exchange rates and revenue and expenses are translated at the average rates during the year. Exchange gains or losses on translation of the Corporation's net equity investment in these operations are deferred as a separate component of shareholders' equity.

The appropriate amounts of exchange gains or losses accumulated in the separate component of shareholders' equity are reflected in income when there is a reduction, as a result of capital transactions, in the Corporation's net investment in the operations that gave rise to such exchange gains or losses.

Employee benefit plans

The cost of pension and post-employment benefits (including medical benefits, dental care, life insurance and certain compensated absences) related to employees' current service is charged to income annually. The cost is computed on an actuarial basis using the projected benefit method prorated on services and management's best estimates of investment yields, salary escalation and other factors. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. Past service costs resulting from plan amendments are amortized on a straight-line basis over the remaining average service life of active employees at the date of amendments. Actuarial gains (losses) arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain (loss) which is more than 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of active employees.

Stock-based compensation plan

Stock options granted after January 1, 2003 are accounted for under the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and recognized over the vesting period with a corresponding credit to contributed surplus. On the exercise of stock options, consideration received and the accumulated contributed surplus amount is credited to capital stock. Stock options granted prior to January 1, 2003 continue to be accounted for using the intrinsic value method, which does not give rise to compensation expense.

Income taxes

The Corporation follows the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Loss per common share

Basic loss per common share is computed by dividing the total of net loss plus preference share dividends by the weighted average number of common shares outstanding during the year. Diluted loss per common share reflects the assumed conversion of all dilutive securities using the "if converted" method for convertible debentures and preference shares and the "treasury stock" method for options.

Under the "if converted" method:

- the convertible subordinated debentures and preference shares are assumed to be converted at the beginning of the year [or at the date of issuance, if later].

Under the "treasury stock" method:

- the exercise of options is assumed to be at the beginning of the year or at the time of issuance, if later;
- the proceeds from the exercise, plus future period compensation expense on options granted on or after January 1, 2003, of options are assumed to be used to purchase common shares at the average price during the year; and
- the incremental number of common shares, which is the difference between the number of shares assumed issued and the number of shares assumed purchased, is included in the denominator of the diluted loss per common share computation.

1. Significant Accounting Policies (cont'd)

Derivative financial instruments

The Corporation in the management of its foreign currency and interest rate exposures utilizes derivative financial instruments. The Corporation's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge anticipated US dollar denominated sales are recognized as an adjustment of the revenues when the sale is recorded. For forward foreign exchange contracts used to hedge anticipated US dollar denominated sales, the portion of the forward premium or discount on the contract relating to the period prior to consummation of the sale is also recognized as an adjustment of revenues when the sale is recorded; and the portion of the premium or discount that relates to the resulting account receivable is amortized as an adjustment of interest expense over the remaining term of the contract.

Realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other current, or non-current, assets or liabilities on the consolidated balance sheets and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in income.

Sale of receivables

Transfers of receivables in securitization transactions are recognized as sales when the Corporation is deemed to have surrendered control over the transferred receivables and consideration in the transferred receivables has been received. The Corporation continues to service the accounts receivables but does not retain any interest in the transferred receivables.

2. CHANGE IN ACCOUNTING POLICY

The principal amount of the Corporation's outstanding convertible debentures of $70,000 due on January 31, 2008 was previously classified as an equity instrument due to the Corporation's ability to settle principal and interest payments by the issuance of common shares. In accordance with the amended standard under CICA 3860, the Corporation has presented the liability component of its convertible debentures as long-term debt and the equity component as other paid-in capital. The liability represents the present value of the principal and interest payments of the debentures and the equity component represents the fair value of the holder's conversion feature. The stated interest payments and accretion expense from adjusting the time value of the principal of the debentures over time are recorded as interest expense in the statement of operations.

The following table represents the changes to the Corporation's consolidated statements of operations and retained earnings for the year ended December 31, 2004 by applying the amended standard retroactively:

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

December 31, 2004	Originally Reported	As Restated
Administrative and general expenses	$ 40,396	$ 40,807
Interest	15,531	23,617
Loss before income taxes	$ (2,583)	$ (11,080)
Recovery of income taxes	(749)	(2,916)
Net loss for the year	(1,834)	(8,164)
Retained earnings, beginning of year	122,853	122,339
Interest and accretion	(5,914)	–
Retained earnings, end of year	$ 115,105	$ 114,175
Loss per common share (basic and fully diluted)	(0.09)	(0.10)

The following table represents the changes to the Corporation's balance sheet as at December 31, 2004 by applying the amended standard retroactively:

CONSOLIDATED BALANCE SHEET

As at December 31, 2004	Originally Reported	As Restated
Other assets	$ 41,254	$ 42,486
Convertible debentures as debt	–	63,042
Other paid-in capital	–	11,100
Convertible debentures as equity	71,980	–
Retained earnings	115,105	114,175

3. ACQUISITION

Effective April 2, 2004, the Corporation acquired certain assets of Moore's (Wallisdown) Limited ("Bournemouth"), including equipment, facilities and certain obligations in order to expand the operations of Magellan Aerospace (UK) Limited ("MALUK"). Bournemouth produces parts through complex machining of aluminum and hard metal alloys primarily for the commercial aerospace industry. The results of Bournemouth have been included in the consolidated financial statements since that date.

The following table summarizes the estimated fair value of the assets acquired and the liabilities assumed at the date of acquisition:

Current assets	$ 14,543
Capital assets	6,798
Liabilities assumed	(10,901)
Net assets acquired and purchase price	$ 10,440

4. UNUSUAL ITEM

During 2003, the Corporation announced its decision to cease operations at its Fleet Industries plant in Fort Erie, Ontario. Management estimated the potential costs and losses resulting from this decision and recorded a charge to net loss in 2003 of $33,273. However, during 2004, the Corporation reached final agreements on ending customer programs and as a result, recorded an additional charge of $5,616, which was the estimated amount to reflect additional costs of transferring and completing contractual obligations. In early 2006, the Corporation sold the manufacturing assets and leased the manufacturing facilities. While various costs remain to be fully settled, management believes the provision for closure previously recorded will be adequate to cover the remaining closure costs.

At December 31, 2005, a balance of $13,888 [2004 – $23,730] remains as a liability. The Corporation expects to settle this liability over the next five years and accordingly, has included $6,929 [2004 – $4,609] in accounts payable and accrued charges while the remaining $6,959 [2004 – $19,121] is recorded in other long-term liabilities. [note 8]

5. INVENTORIES

	2005	2004
Production costs of contracts currently in process	**$ 186,231**	$ 174,895
Excess of production cost of delivered units over the estimated average of all units expected to be produced [learning curve costs]	**28,467**	23,968
Engineering and other costs	**71,163**	86,965
	285,861	285,828
Less advances and progress payments	**17,271**	16,093
	$ 268,590	$ 269,735

Learning curve costs involve measurement uncertainty, and accordingly, the carrying amounts could be materially different from the amounts recovered.

The Corporation is in negotiations with one of its customers over amendments to pricing with respect to an existing long-term contract. While it is probable that the Corporation will be successful in its negotiations, the final outcome is not determinable at the present time. If the negotiations are not successful or the final terms differ from what the Corporation expects, the Corporation may be required to record a loss provision on this contract. The amount of such provision, if any, cannot be reasonably estimated until such amendments are finalized.

6. CAPITAL ASSETS

	2005		
	Cost	Accumulated depreciation	Net book value
Land	$ 14,427	$ –	$ 14,427
Buildings	91,046	25,297	65,749
Machinery and equipment	311,545	126,822	184,723
	$ 417,018	$ 152,119	$ 264,899

	2004		
	Cost	Accumulated depreciation	Net book value
Land	$ 15,668	$ –	$ 15,668
Buildings	90,946	22,823	68,123
Machinery and equipment	304,010	113,077	190,933
	$ 410,624	$ 135,900	$ 274,724

Included in machinery and equipment are construction in progress expenditures of $4,691 [2004 – $4,396].

The above amounts include $8,118 [2004 – $8,118] of capital assets under capital leases and accumulated amortization of $1,141 [2004 – $632] related thereto.

7. BANK INDEBTEDNESS

Bank indebtedness of $113,824 [2004 – $68,028] is payable on demand and bears interest at the bankers' acceptance or LIBOR rates, plus 1.0% (4.9% at December 31, 2005). Included in the amount outstanding at December 31, 2005 is US$71,000 [2004 – US$52,537]. At December 31, 2005, the Corporation had drawn $113,824 under the operating credit and had issued letters of credit totaling $2,017 such that $30,871 was unused and available. A fixed and floating charge debenture on accounts receivable, inventories and capital assets is pledged as collateral for the operating loans and the term bank loan. The credit facility is fully guaranteed by the Chairman of the Board of Directors. An annual fee of $155 is paid in consideration for the guarantee.

8. OTHER LONG-TERM LIABILITIES & COMMITMENTS

	2005	2004
Non-interest bearing amounts owed to third parties	$ 22,556	$ 29,007
Accrued costs related to plant and program closures	13,888	23,730
Other	1,751	–
	38,195	52,737
Less current portion included in accounts payable and accrued charges	23,134	19,811
	$ 15,061	$ 32,926

8. Other Long-Term Liabilities & Commitments (cont'd)

Amounts are due as follows:

2006	$ 23,134
2007	8,579
2008	1,665
2009	1,682
2010	1,712
Thereafter	1,423
	$ 38,195

The non-interest bearing amounts are net of an unamortized discount of $957 based on an average imputed interest rate of 6.5%. The amounts will be accreted to their face amount of $23,513 through periodic charges to interest expense.

Future minimum lease payments

Future minimum annual lease payments under operating leases are as follows:

2006	$ 4,823
2007	4,499
2008	4,181
2009	2,065
2010	761
Thereafter	715
	$ 17,044

9. LONG-TERM DEBT

	2005	2004
Term bank loan	**$ –**	$ 46,316
Other non-bank loans	**6,013**	6,774
Obligations under capital leases (bearing interest at 6.0% to 7.9%)	**5,796**	7,101
	11,809	60,191
Less current portion	**2,201**	48,335
	$ 9,608	$ 11,856

Long-term debt is comprised of capital leases and other loans provided by governmental authorities.

Long-term debt maturities for the next five years and thereafter are as follows:

2006	$ 2,201
2007	1,650
2008	1,640
2009	1,587
2010	1,503
Thereafter	3,228
	$ 11,809

Included within the above schedule of future principal repayments of long-term debt are obligations under capital leases. Future minimum lease payments under the capital leases in effect at December 31, 2005 are as follows:

2006	$ 1,459
2007	1,320
2008	1,237
2009	950
2010	813
Thereafter	1,288
Total minimum lease payments	7,067
Less capital lease payments representing interest	1,271
Present value of capital lease payments	**$ 5,796**

10. CONVERTIBLE DEBENTURES

On January 7, 2003, the Corporation completed an offering of $70,000 of 8.5% convertible unsecured subordinated debentures, due January 31, 2008. The debentures pay interest on a semi-annual basis on January 31 and July 31 in each year commencing July 31, 2003. The debentures are convertible, at any time prior to the maturity date, by the holders into common shares of the Corporation, at a conversion price of $4.50 per common share. The debentures are redeemable by the Corporation between January 31, 2006 and January 31, 2007 at a price equal to the principal amount, plus accrued and unpaid interest, if any, provided that the current market price is not less than 125% of the conversion price, and after January 31, 2007 and prior to the maturity date at a price equal to the principal amount, plus accrued and unpaid interest, if any. On redemption or maturity, the Corporation will have the option of retiring the convertible debentures with common shares in which case the number of common shares issuable is based on 95% of the weighted average trading price of the Corporation's common shares for the 20 consecutive trading days prior to the date fixed for redemption or maturity. In addition, the Corporation may elect from time to time to issue and deliver freely tradeable common shares to a trustee in order to raise funds to satisfy the obligation to pay interest on the convertible debentures. The debentures are unsecured obligations of the Corporation and will be subordinated in right of payment to all of the Corporation's existing and future senior indebtedness.

As a result of these terms and as explained under "Significant Accounting Policies – Convertible Debentures", $11,100 has been attributed to the equity component of the debenture and has been included under Other paid in capital. $65,141 [2004 – $63,042] has been attributed to the debt component and is included in long-term liabilities. The difference between the carrying value and the face value of the debentures will be accreted through periodic charges to income included in interest expense over the life of the debenture.

The Chairman of the Board of the Corporation holds $15,000 of these debentures. The related cash interest for the year was $1,275 [2004 – $1,275].

11. CAPITAL STOCK

The authorized capital of the Corporation consists of an unlimited number of Preference Shares, issuable in series, and an unlimited number of common shares.

Preference Shares:

Series A	Number of shares	Stated capital
Outstanding at December 31, 2004	–	$ –
Issued through private placement	2,000,000	19,949
Outstanding at December 31, 2005	**2,000,000**	**$ 19,949**

On May 27, 2005, the Corporation issued 2,000,000, 8% Cumulative Redeemable First Preference Shares Series A ("Preference Shares") at a price of $10.00 per preference share for total gross proceeds of $20,000. Each preference share is convertible at the holder's option into 3.33 common shares of Magellen (6,666,667 common shares in aggregate) at a price of $3.00 per common share. The Preference Shares will not be redeemable by the Corporation at any time prior to July 1, 2008. Thereafter, the Preference Shares are redeemable, under certain conditions, at the option of the Corporation at $10.00 per preference share plus accrued and unpaid dividends. In addition, on or after July 1, 2010, under certain circumstances the holder has the right to require the Corporation redeem the shares at $10.00 per preference share plus accrued and unpaid dividends. Directors and officers of the Corporation purchased directly or indirectly 1,135,000 of the Preference Shares issued.

Common shares:

	Number of shares	Stated capital
Outstanding at December 31, 2003	79,337,128	$ 182,733
Issued as part of rights offering	11,337,568	31,068
Issued to employees and directors	65,782	161
Outstanding at December 31, 2004	90,740,478	213,962
Issued to employees and directors	51,932	147
Outstanding at December 31, 2005	**90,792,410**	**$ 214,109**

In 2004, the Corporation completed a rights offering and issued 11,337,568 common shares for net proceeds of $31,068.

Under the terms of the Corporation's Employee Share Purchase Plan ("ESPP"), eligible employees are able to purchase common shares at 100% of the average market price for the period preceding the purchase. The Corporation matches purchased shares on a 50% basis after a prescribed vesting period. During the year, the Corporation issued 28,852, common shares [2004 – 43,038] under the ESPP for $84 [2004 – $95] and at December 31, 2005, 251,474 common shares are reserved for issue.

The reconciliation of the numerator and denominator for the calculation of basic and diluted loss per common share is as follows:

	2005	2004
Net loss	**$ (6,076)**	$ (8,164)
Dividends on Preference Shares	**(1,080)**	–
Loss attributable to common shareholders	**(7,156)**	(8,164)
Weighted average shares outstanding	**90,753,746**	82,496,847
Net effect of dilutive instruments	**–**	–
Diluted weighted average shares outstanding	**90,753,746**	82,496,847
Loss per common share		
Basic	**$ (0.08)**	$ (0.10)
Diluted	**$ (0.08)**	$ (0.10)

As a result of the net loss for the years ended December 31, 2005 and 2004, there is no dilutive effect of the stock options and convertible debentures.

12. STOCK-BASED COMPENSATION PLAN

The Corporation has an incentive stock option plan, which provides for the granting of options for the benefit of employees and directors. The maximum number of options for common shares that remain to be granted under this plan is 2,050,903. Options are granted at an exercise price that will be the market price of the Corporation's common shares at the time of granting. Options normally have a life of five years with vesting at 20% at the end of the first, second, third, fourth and fifth years from the date of the grant. In addition, certain business unit income tests must be met in order for the optionholder's entitlement to fully vest.

A summary of the plan and changes during each of 2005 and 2004 are as follows:

	2005		2004	
	Shares	**Weighted average exercise price**	Shares	Weighted average exercise price
Outstanding, beginning of year	**2,556,500**	**$ 4.44**	1,948,000	$ 5.84
Granted	**1,545,000**	**2.65**	1,103,500	3.00
Forfeited/expired	**(801,700)**	**5.00**	(495,000)	6.76
Outstanding, end of year	**3,299,800**	**$ 3.47**	2,556,500	$ 4.44

The following table summarizes information about options outstanding and exercisable at December 31, 2005:

	Options outstanding			**Options exercisable**	
Range of exercise prices ($)	**Number outstanding at December 31, 2005**	**Weighted average remaining contractual life [in years]**	**Weighted average exercise price**	**Number exercisable at December 31, 2005**	**Weighted average exercise price**
2.65 – 3.00	**2,476,500**	**4.60**	**$ 2.79**	**113,700**	**$ 3.00**
4.80 – 6.55	**823,300**	**1.52**	**5.49**	**407,400**	**5.66**
	3,299,800	**3.83**	**$ 3.47**	**521,100**	**$ 5.08**

The Corporation accounts for stock options granted after January 1, 2003 under the fair value method. Compensation expense recorded during the year was $620 [2004 – $234].

For the stock options granted prior to January 1, 2003 the Corporation follows the intrinsic value method, which does not give rise to compensation expense. Under Canadian generally accepted accounting principles, the Corporation is required to disclose compensation expense as if the Corporation had elected to follow the fair value method for such options.

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

	2005	2004
Risk-free interest rate	**3.14%**	3.65%
Expected volatility	**35%**	52%
Expected average life of the options	**4 years**	4 years
Expected dividend yield	**0%**	0%

The weighted average fair value of stock options granted in 2005 was $1.02 [2004 – $1.32].

12. Stock-Based Compensation Plan (cont'd)

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

For purposes of pro forma disclosures, the Corporation's net loss attributable to its common shares and basic and diluted loss per common share for options granted prior to January 1, 2003 would have been as follows:

	2005	2004 (restated note 2)
Net loss, as reported	$ (6,076)	$ (8,164)
Pro forma compensation expense	(216)	(248)
Pro forma net loss	(6,292)	(8,412)
Dividends on Preference Shares	(1,080)	–
Loss attributable to common shareholders	(7,372)	(8,412)
Pro forma loss per common share:		
Basic	$ (0.08)	$ (0.10)
Diluted	$ (0.08)	$ (0.10)

13. FOREIGN EXCHANGE TRANSLATION

Unrealized translation adjustments, which arise on the translation to Canadian dollars of assets and liabilities of the Corporation's self-sustaining foreign operations, resulted in an unrealized currency translation loss of $9,460 for the year ended December 31, 2005 [2004 – $12,156], which is reflected as foreign exchange translation on the consolidated balance sheets and has no impact on net loss for the year. The unrealized loss resulted from the strengthening of the Canadian dollar against the U.S. dollar, and the strengthening of the Canadian dollar against the Great Britain Pound Sterling.

14. SUPPLEMENTARY INFORMATION

[a] Interest expense on long-term debt in 2005 was $10,708 [2004 – $11,191].

[b] During 2005, the Corporation received $2,023 [2004 – $7,581] of a government investment, which has been credited to the related assets. The Corporation is eligible for an additional $7,463 for the period from January 1, 2006 to December 31, 2008 based on approved expenditures. The investment is repayable as royalties ranging from 1% to 3% of certain future revenue.

[c] Details of changes in non-cash working capital balances related to operating activities are as follows:

	2005	2004
Accounts receivable	$ 5,009	$ 18,323
Inventories	(5,736)	2,750
Prepaid expenses and other	(1,756)	(1,145)
Accounts payable and accrued charges	436	(9,653)
	$ (2,047)	$ 10,275

[d] Cash interest paid during 2005 amounted to $17,463 [2004 – $19,999] and a refund of cash income taxes during 2005 amounted to $947 [2004 – refund of $3,017].

[e] During the year, the Corporation incurred a foreign exchange gain on the conversion of foreign currency denominated working capital balances and debt of $1,624 [2004 – $3,914].

[f] In the 2004 fiscal year, the Corporation entered into a 5-year accounts receivable securitization program permitting it to sell on an on-going basis, an undivided co-ownership interest in certain of its trade accounts receivable to a securitization trust (the "Trust") to a maximum of $46,000. The total amount transferred to the Trust during the year amounted to $215,341 [2004 – $124,510] for a discount of $1,410 [2004 – $1,274] representing an annualized interest rate of 5.16%. The discount has been included in interest expense in the consolidated statements of operations and retained earnings. Included in accounts receivable as at December 31, 2005, is a cash reserve of $7,066 [2004 – $6,151], which the Trust has invested in trust for the Corporation. The reserve represents the portion of the consideration which is withheld from the Corporation until payments are received by the Trust. During the year, the reserve earned investment income of $181 [2004 – $36], which is included in interest income. The Trust and its investors have no recourse on the Corporation's other assets for failure of the debtors to pay when due, other than retained interest in the Trust.

During the year, the Corporation sold receivables to various financial institutions in the amount of $56,961 [2004 – $38,137], for a discount of $660 [2004 – $483].

During the year, the Corporation sold receivables to a corporation with a common director in the amount of $15,063 [2004 – $14,700], for a discount of $131 [2004 – $184]. Included in this balance, as at December 31, 2005, is a reserve of $592 [2004 – $516].

[g] Other assets consist of the following:

	2005	2004 (restated note 2)
Technology rights	$ 38,145	$ 31,362
Pension benefit asset [note 16]	4,455	8,107
Other	3,867	3,017
	$ 46,467	$ 42,486

Technology rights relate to an agreement signed during 2003, which permits the Corporation to manufacture aerospace engine components and share in the revenue generated by the final sale of the engine. A follow on contract was signed in 2005.

[h] Contributed surplus arises solely from the recording of stock based compensation expense.

15. INCOME TAXES

The following is a reconciliation of the expected tax recovery obtained by applying the combined corporate tax rates to loss before income taxes:

	2005	2004 (restated note 2)
Corporate tax rate for manufacturing companies	37.5%	40.5%
Expected tax recovery	$ (3,051)	$ (4,483)
Benefit of capital loss carryforwards	(279)	—
Non deductible accretion and stock option charges	1,005	841
Permanent differences and other	(33)	206
Large Corporations Tax	306	520
	$ (2,052)	$ (2,916)

15. Income Taxes (cont'd)

Components of future income tax assets and liabilities by jurisdiction are summarized as follows:

	2005	2004
Canada		
Future income tax asset – current		
Accounting provisions not currently deductible for tax purposes	$ 1,866	$ 3,724
Future income tax assets – long-term		
Operating loss carryforwards	8,303	10,564
Investment tax credits	13,043	6,519
Accounting provisions not currently deductible for tax purposes	16,830	15,217
	38,176	32,300
Future income tax liabilities – long-term		
Tax depreciation in excess of book depreciation	35,627	38,383
Deferred employee future benefits	3,309	2,927
	$ 38,936	$ 41,310
United States		
Future income tax asset – current		
Accounting provisions not currently deductible for tax purposes	$ 1,652	$ 3,380
Future income tax assets – long-term		
Operating loss carryforwards and investment tax credits	10,287	7,228
Accrued employee future benefits	285	490
	10,572	7,718
Future income tax liability – long-term		
Tax depreciation in excess of book depreciation	$ 38,365	$ 41,035
United Kingdom		
Future income tax asset – long-term		
Accounting provisions not currently deductible for tax purposes	$ 2,004	$ 2,300

The Corporation has operating loss carryforwards in the United Kingdom of approximately $9,743 for which no benefit has been recognized in the consolidated financial statements. Loss carryforwards in the United Kingdom do not expire.

The Corporation operates in different jurisdictions and accordingly it is subject to income and other taxes under the various tax regimes in the countries in which it operates. The tax rules and regulations in many countries are highly complex and subject to interpretation. The Corporation may be subject in the future to a review of its historical income and other tax filings and in connection with such reviews, disputes can arise with the taxing authorities over the interpretation or application of certain tax rules and regulation to the Corporation's business conducted with the country involved. The Corporation is not aware of any pending review of its filing positions for which adequate reserves have not been provided in these financial statements.

16. 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.

Consolidated cash payments contributed by the Corporation for employee future benefits related to its defined benefit and defined contribution pension plans and payments directly to beneficiaries for its unfunded other benefits plan was $12,738 [2004 – $11,122].

[a] Defined contribution plans

The Corporation's expenses for defined contribution plans for the year ended December 31, 2005 was $4,414 [2004 – $4,130]. Assets and obligations for these plans at December 31, 2005 amounted to $53,359 [2004 – $54,707].

[b] Defined benefit plans

The Corporation's defined benefit plans cover payments for pensions, and other benefit plans described as follows:

Pensions plans:

The Corporation's pension plans provide eligible employees with pension benefits based on a number of criteria including earnings, years of service, retirement age, and specified benefit levels, and include both final average earnings formulae and minimum benefit formulae.

Actuarial valuations for funding purposes are prepared and filed with the appropriate regulatory authorities at least tri-annually.

Other benefit plans:

In one acquired division, the Corporation has an other benefit plan to provide post-employment coverage for health care benefits including prescribed drugs, hospital and other medical, dental and vision benefits for eligible retired employees, their spouses and eligible dependants. Other benefit plans provide for post-employment life insurance and compensated absences for eligible current employees, including vacation to be taken before retirement, if certain age and service are met.

The following table summarizes the changes in benefit obligation and plan assets of the Corporation's defined benefit plans, in aggregate:

	Pension		Other benefit plans	
	2005	2004	**2005**	2004
Change in benefit obligation				
Benefit obligation, beginning of year	**$ 93,200**	$ 92,946	**$ 1,229**	$ 1,284
Member contributions during the year	**286**	313	**–**	–
Current service cost (employer)	**1,949**	1,860	**–**	–
Interest cost	**6,407**	6,554	**86**	104
Benefits paid	**(8,537)**	(9,686)	**(597)**	(875)
Actuarial loss	**14,535**	2,034	**375**	812
Foreign exchange loss	**(334)**	(821)	**–**	(96)
Benefit obligation, end of year	**$ 107,506**	$ 93,200	**$ 1,093**	$ 1,229
Change in plan assets				
Market value of plan assets – beginning of year	**$ 84,726**	$ 80,974	**$ –**	$ –
Actual return on plan assets	**8,767**	7,540	**–**	–
Member contributions during the year	**286**	345	**–**	–
Employer contributions	**7,727**	6,177	**–**	–
Benefits paid	**(8,466)**	(9,686)	**–**	–
Foreign exchange loss	**(265)**	(624)	**–**	–
Market value of plan assets – end of year	**$ 92,775**	$ 84,726	**$ –**	$ –
Reconciliation of funded status				
Funded status – deficit	**$ (14,731)**	$ (8,474)	**$ (1,093)**	$ (1,229)
Unamortized past service costs	**620**	900	**–**	–
Unamortized net actuarial loss	**18,566**	15,681	**–**	–
Accrued benefit asset (liability)	**$ 4,455**	$ 8,107	**$ (1,093)**	$ (1,229)

The accrued benefit asset related to pensions is included in other assets and the accrued benefit liability related to other benefit plans is included in other long-term liabilities.

16. Employee Future Benefits (cont'd)

Plans with accrued benefit obligation in excess of plan assets:

Included in the above accrued benefit obligation and fair value of plan assets are the following amounts in respect of plans that are not fully funded:

	Pension		Other benefit plans	
	2005	2004	**2005**	2004
Benefit obligation	**$ 107,506**	$ 87,965	**$ (1,093)**	$ (1,229)
Market value of plan assets	**92,775**	78,653	**–**	–
Funded status – deficit	**$ (14,731)**	$ (9,312)	**$ (1,093)**	$ (1,229)

Net benefit plan costs:

The components of the Corporation's net benefit costs are as follows:

	Pension		Other benefit plans	
	2005	2004	**2005**	2004
Current service cost	**$ 1,949**	$ 1,860	**$ –**	$ –
Interest cost	**6,407**	6,554	**86**	104
Actual return on plan assets	**(8,767)**	(7,540)	**–**	–
Actuarial losses	**14,535**	2,034	**375**	812
Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefits	**14,124**	2,908	**461**	916
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between expected return and actual return on plan assets for the year	**2,719**	1,795		–
Differences between actuarial loss recognized for the year and actual actuarial losses on accrued benefit obligation for the year	**(14,050)**	(1,495)		–
Difference between amortization of past service costs for the year and actual plan amendments for the year	**281**	281		–
Net benefit cost recognized	**$ 3,074**	$ 3,489	**$ 461**	$ 916

Significant assumptions and sensitivity analysis

The significant actuarial assumptions adopted in measuring the Corporation's accrued benefit obligations represent management's best estimates reflecting the long-term nature of employee future benefits and are as follows [weighted-average assumptions as at December 31]:

	Pension		Other benefit plans	
	2005	2004	**2005**	2004
Accured benefit obligation at December 31				
Discount rate	**6.0%**	7.0%	**7.0%**	8.5%
Expected long-term rate of return on plan assets	**7.0%**	7.0%	**–**	–
Rate of compensation increase	**3.0%**	3.0%	**–**	–

	2005	2004	**2005**	2004
Benefit cost for the years ended December 31				
Discount rate	**7.0%**	7.0%	**7.0%**	8.5%
Expected long term rate of return on plan assets	**7.0%**	7.0%	**–**	–
Rate of compensation increase	**3.0%**	3.0%	**–**	–

For measurement purposes, a 5.0% to 10.0% annual rate of increase in the per capita cost of covered health care and dental benefits was assumed for 2005. The rate was assumed to decrease gradually over the next 10 years to 3.0% and to remain at that level thereafter.

The impact of applying a one-percentage-point increase and decrease in the assumed health care and dental benefit trend rates as at December 31, 2005 was nominal.

Plan assets:

The percentage of the fair value of total pension plan assets held at the measurement date of December 31 of each year were as follows:

Asset Category	Percentage of plan assets	
	2005	2004
Equities	**58.0%**	57.2%
Fixed income	**35.7%**	42.4%
Cash and short-term investments	**6.3%**	0.4%
Total	**100.0%**	100.0%

At December 31, the market value of the plan assets directly invested in common shares of the Corporation was as follows:

	2005	2004
Defined benefit plans	**$ 135**	$ 134

17. SEGMENTED INFORMATION

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

Domestic and foreign operations consist of the following:

	2005				2004			
	Canada	**U.S.**	**U.K.**	**Total**	Canada	U.S.	U.K.	Total
Revenues								
Domestic	**$ 96,100**	**$ 148,693**	**$ 101,493**	**$ 346,286**	$ 102,977	$ 156,004	$ 93,923	$ 352,904
Export	**181,430**	**35,118**	**5,649**	**222,197**	184,636	29,587	6,652	220,875
Total revenues	**277,530**	**183,811**	**107,142**	**568,483**	287,613	185,591	100,575	573,779
Capital assets, net	**$ 126,181**	**$ 125,783**	**$ 12,935**	**$ 264,899**	$ 128,446	$ 136,334	$ 9,944	$ 274,724

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

	2005	2004
Major customers		
Canadian operations		
Number of customers	**4**	2
Percentage of total Canadian revenue	**41%**	25%
U.S. operations		
Number of customers	**3**	4
Percentage of total U.S. revenue	**57%**	65%
U.K. operations		
Number of customers	**1**	1
Percentage of total U.K. revenue	**80%**	65%

18. FINANCIAL INSTRUMENTS

[a] Fair value

The Corporation has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, with the exception of the convertible debentures, considerable judgment 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 below:

Cash, accounts receivable, bank indebtedness and accounts payable and accrued charges
Due to the short period to maturity of these instruments, the carrying values as presented in the consolidated balance sheets are reasonable estimates of their fair values.

Long-term debt
The fair value of the Corporation's long-term debt, based on current rates for debt with similar terms and maturities, is not materially different from its carrying value.

Convertible debentures
The fair market value of the Corporation's convertible debentures, calculated based on the available market data at December 31, 2005 was $70,875.

[b] Credit risk

The Corporation's financial assets that are exposed to credit risk consist primarily of cash and accounts receivable.

The Corporation, in the normal course of business, is exposed to credit risk from its customers, substantially all of which are in the aerospace industry. These accounts receivable are subject to normal industry credit risks.

[c] Interest rate risk

The Corporation is exposed to significant interest rate risk due to its bank indebtedness being at variable rates.

[d] Forward foreign exchange contracts

The Corporation uses derivative financial instruments to manage foreign exchange risk. The Corporation does not trade in derivatives for speculative purposes.

The Corporation has entered into forward foreign exchange contracts to hedge future cash flows in U.S. dollars. Under this contract the Corporation is obliged to purchase specific amounts of U.S. dollars at predetermined date and exchange rate. These contracts are matched with anticipated operational cash flows in U.S. dollars.

The Corporation has a U.S. dollar forward contract outstanding at December 31, as follows:

	2005	
	Amount	**Exchange rate**
Maturity – less than 1 year	**$ 8,500**	**1.1665**

19. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2005 consolidated financial statements.

CORPORATE OFFICERS

N. Murray Edwards
Chairman

Richard A. Neill
President and
Chief Executive Officer

James S. Butyniec
Executive Vice President and
Chief Operating Officer

Brian A. Little
Senior Vice President
Information Technology,
Strategy & Business Development

John B. Dekker
Vice President, Finance and
Corporate Secretary

William A. Matthews
Vice President, Marketing

Jo-Ann C. Ball
Vice President,
Human Resources

Larry A. Winegarden
Vice President,
Corporate Strategy

Konrad B. Hahnelt
Vice President,
Strategic Global Sourcing

Steven P. Groot
Corporate Controller & Treasurer

BOARD OF DIRECTORS

N. Murray Edwards
Chairman,
Magellan Aerospace Corporation
President,
Edco Financial Holdings Ltd.,
Calgary, Alberta

Richard A. Neill
President and
Chief Executive Officer,
Magellan Aerospace Corporation,
Mississauga, Ontario

Hon. William G. Davis,
P.C., C.C., Q.C. (3)
Counsel,
TORYS LLP,
Toronto, Ontario

William A. Dimma,
C.M., O. Ont. (1, 2)
Board Chairman,
Home Capital Group,
Toronto, Ontario

Bruce W. Gowan (1, 3)
Corporate Director,
Huntsville, Ontario

Donald C. Lowe (1, 4)
Corporate Director,
Toronto, Ontario

Larry G. Moeller (4)
Vice President Finance,
Edco Financial Holdings Ltd.,
Calgary, Alberta

James S. Palmer, C.M., Q.C. (2, 3)
Chairman,
Burnet, Duckworth & Palmer,
Calgary, Alberta

Hon. M. Douglas Young, P.C. (2, 4)
Chairman,
Summa Strategies Canada Inc.,
Ottawa, Ontario

COMMITTEES OF THE BOARD

1 Audit Committee
Chairman:
William A. Dimma

2 Governance and Nominating Committee
Chairman:
M. Douglas Young

3 Human Resources and Compensation Committee
Chairman:
William G. Davis

4 Environmental and Safety Committee
Chairman:
Donald C. Lowe

Operating Facilities Directory and Shareholder Information

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660 Berry Street,
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Tel: 613 432 8841

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Massachusetts 01949
Tel: 978 774 6000

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5401 West Luke Avenue, Glendale,
Arizona 85311
Tel: 623 939 9441

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Poole, Dorset BH12 5HF
Tel: 01202 535536

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Tel: 01978 856798

Rackery Lane,
Llay, Wrexham LL12 0PB
Tel: 01978 852101

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For investor information:
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Toronto, Ontario

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Toronto, Ontario
Tel: 1 800 564 6253
e-mail:
service@computershare.com
www.computershare.com

STOCK LISTING

Toronto Stock Exchange – TSX
Common Shares – MAL
Convertible Debentures – MAL.DB

ANNUAL MEETING

The Annual Meeting of the Shareholders of Magellan Aerospace Corporation will be held on Thursday, May 11th, 2006 at 2:00 p.m. at The Living Arts Centre, 4141 Living Arts Drive, Mississauga, Ontario L5B 4B8

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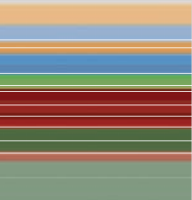

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MAGELLAN
AEROSPACE CORPORATION
3160 Derry Road East Mississauga Ontario Canada L4T 1A9

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