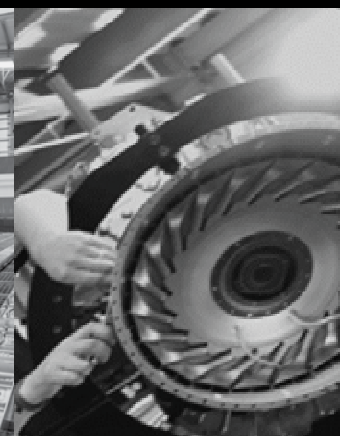
MAGELLAN AEROSPACE







# ANNUAL REPORT 2019

**WE EXPERIENCED GROWTH IN OUR MILITARY PROGRAMS INCLUDING THE JOINT STRIKE FIGHTER PROGRAM WHERE WE DELIVERED A RECORD NUMBER OF HORIZONTAL TAIL ASSEMBLIES DURING THE YEAR.**

With the cancellation of the A380 program and the temporary suspension of production of the Boeing 737 Max, 2019 was a challenging year for the aerospace sector. These significant program issues were compounded by the lower than planned ramp up by Airbus on the A320 and A350 programs, along with a reduction in the A330 wide bodied aircraft. All of these program disruptions adversely affected our performance during 2019. On the positive side, we experienced growth in our military programs including the joint strike fighter program where we delivered a record number of horizontal tail assemblies during the year.

Whilst 2019 has been impacted by these program disruptions, many industry analysts predict that the current super cycle will continue through the end of this decade with over 44,000 aircraft deliveries forecast over the next 20 years. To ensure we are positioned to exploit this demand Magellan continues to align its strategy with that of our major customers and focus on optimising our operational performance in all areas of our business providing our products and services consistently with ZERO DEFECTS and 100% ON TIME. This level of operational performance coupled with market-competitive pricing is a prerequisite for our continued success.

We finished the year with slightly over $1 billion in revenue and EBITDA of $145.2 million and continued our trend of maximizing cash flow and strengthening our balance sheet. In 2020, we will mitigate the impact of the suspension of production on the 737 Max on our operations through continued management of cash and driving operational improvements. Return for our shareholders remains a priority for Magellan. With this in mind, we increased our dividend by 5% in 2019, the 6th consecutive year of dividend increases since first issuance. Our financial situation remains solid with a strong balance sheet that enables our future growth and allows the Company to make strategic acquisitions if they arise.

During 2019, we increased our low cost footprint, opening a new high speed machining facility in Bangalore India. In April we were able to announce that we had secured a contract from Boeing to produce the Leading Edge Rib assemblies for the 777X aircraft, our first major contract for this new facility. This coupled with our increased holding in Triveni, the expansion of our Polish facility and the acquisition of our first business in France provides us with an opportunity to not only offer competitive solutions to our customers, but also support their local operations and industrial participation strategies.

Another success was achieved in 2019 in securing two major munitions development programs for our Winnipeg facility, the SeaSpider® Anti Torpedo Torpedo and the LUU-2 Illumination flare for the RCAF. These two projects once in full production will improve the balance in our business between commercial and defence programs.

## IT IS VITAL THAT INVESTMENT CONTINUES ALONG WITH A SUSTAINED DRIVE IN OPERATIONAL PERFORMANCE.

Progress is being made in standardizing our operating platform. This involves putting in place structures, systems and processes that will allow us to be more agile and efficient today and for future growth. Accordingly, in 2020 the focus continues on our SAP system implementation across our European operations to drive a leaner more efficient business.

Magellan's environmental council promotes collaboration across the Company and provides a structure to focus environmental efforts effectively for continual improvement through our environmental management system and our overall environmental performance. We have developed key metrics for environmental, social and governance objectives and over the past ten years have reduced our GHG emissions in excess of 50%.

We will continue to invest in our employees through training and modern apprenticeships as well as provide a safe and rewarding environment for our people, with a goal to provide them with long and rewarding careers with Magellan. I would like to express my appreciation to our employees for their continued commitment and support throughout this year.

As we continue on this journey, focusing on delivering operational excellence in all areas of our business, and investing in our employees, systems and advanced technologies, we will continue to deliver strong financial performance and growth into the next decade.

**Phillip C. Underwood**
*President and Chief Executive Officer*
March 6, 2020

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of Magellan Aerospace Corporation ("Magellan" or the "Corporation") should be read in conjunction with the audited consolidated financial statements and the notes thereto for the years ended December 31, 2019 and 2018 prepared in accordance with International Financial Reporting Standards ("IFRS"), and the Annual Information Form for the year ended December 31, 2019 (available on SEDAR at www.sedar.com). This MD&A provides a review of the significant developments that have impacted the Corporation's performance during the year ended December 31, 2019 relative to the year ended December 31, 2018. The information contained in this report is as at March 6, 2020. All financial references are in Canadian dollars unless otherwise noted.

The MD&A contains forward-looking information that represents the Corporation's internal projections, expectations, estimates or beliefs concerning, among other things, future operating results and various components thereof or the Corporation's future economic performance. These statements relate to future events or future performance. All statements other than statements of historical facts may be forward-looking statements. In particular and without limitation there are forward looking statements under the heading "Overview," "2019 and Recent Updates," "Outlook," "Consolidated Revenues," "Liquidity and Capital Resources," "Risk Factors," "Critical Accounting Estimates" and "Future Changes in Accounting Policies." In some cases, forward-looking statements can be identified by terminology such as "may," "will," "should," "could," "expects," "forecasts," "believes," "projects," "plans," "anticipates," and similar expressions. The projections, estimates and beliefs contained in such forward-looking statements are based on management's assumptions relating to the production performance of Magellan's assets and competition throughout the aerospace industry in 2019 and continuation of the current regulatory and tax regimes in the jurisdictions in which the Corporation operates, and necessarily involve known and unknown risks and uncertainties, including the business risks discussed in this MD&A, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. In particular, the Corporation has not adjusted or revised any forward-looking statements in this report to account for the potential disruption to its business from the recent novel coronavirus ("coronavirus") outbreak, the impact from which is not immediately known or quantifiable. Except as required by law, the Corporation does not undertake to update any forward-looking information in this document whether as a result of new information, future events or otherwise.

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

## 1. OVERVIEW

A summary of Magellan's business and significant 2019 events

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

During 2019, the Corporation advanced a number of key initiatives including the implementation of the first phase of a corporate-wide ERP system, the strengthening of its strategic planning process, and increasing the focus on zero defects and 100% on-time delivery. Advancing these initiatives along with other improvement plans is vital in an increasingly competitive market.

Magellan operates substantially all of its activities in one reportable segment, Aerospace, which is viewed as one segment by the chief operating decision-makers for the purpose of resource allocations, assessing performance and strategic planning. The Aerospace segment includes the design, development, manufacture, repair and overhaul and sale of systems and components for defence and civil aviation. The Corporation supplies both the commercial and defence sectors of the Aerospace segment. In the commercial sector, the Corporation is active in the large commercial jet, business jet, regional aircraft, and helicopter markets. On the defence side, the Corporation provides parts and services for major military aircraft.

Within the Aerospace 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 aerostructures product grouping, the Corporation supplies international customers by producing components to aerospace tolerances using conventional and high-speed automated machining centres. Capabilities include precision casting of airframe-mounted components. Management believes that Magellan's dedication to technological innovation combined with low cost sourcing from emerging markets will position the Corporation to capture targeted complex assembly programs.

Within the aeroengines product grouping, the Corporation manufactures complex castings, fabricated and machined gas turbine engine components, both static and rotating, integrated nacelle components, flow path and engine exhaust systems for the world's leading aeroengine manufacturers. The Corporation also performs repair and overhaul services for jet engines and related components.

In 2019, 68% of revenues were derived from commercial markets (2018 – 69%, 2017 – 73%) while 32% of revenues related to defence markets (2018 – 31%, 2017 – 27%).

**2019 and Recent Updates**

Magellan announced on March 15, 2019 three five-year agreements valued at $48 million in aggregate, with the Canadian government to perform the licensed manufacture of LUU-2 Illumination flares for the RCAF. Magellan-produced flares will be delivered from the Magellan's propellant plant, located near Winnipeg, Manitoba.

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

The Corporation announced on April 24, 2019 a multi-year agreement with Boeing to manufacture 777X control surface ribs in support of Boeing's Focused Factory initiative. Work will begin at its United Kingdom facility and later transition to a new factory in Bangalore, India. Boeing's Focused Factory initiative is the aggregation of products grouped by commonality and forecasted demand. The product groups utilize similar technologies and aggregating the products creates economies of scale that deliver lower cost, improved quality, and delivery efficiencies.

On April 29, 2019 Magellan announced agreements with an undisclosed customer for the supply of complex fabricated engine front frames for a commercial platform, to be manufactured at Magellan's facility in Winnipeg, Manitoba, and critical rotating engine shafts for a dual use platform to be manufactured at Magellan's facility in Haverhill, Massachusetts. The agreements are valued at approximately $45 million with delivery over the course of the next three years.

Magellan announced on May 14, 2019 that it will continue producing F-35 Lightning II ("F-35") horizontal tail assemblies under an agreement with BAE Systems. This agreement represents the continuation of contract awards for three additional years. With the additional quantities awarded, Magellan will now produce more than double the horizontal tails produced thus far for the global F-35 program. Annual deliveries will ramp up to 60 per year within the three year period. Magellan, through its operations in Winnipeg, Manitoba, and BAE Systems have been working together to produce horizontal tails for the global F-35 program for more than a decade.

The Corporation announced on November 7, 2019 that it completed the acquisition of 100% of the outstanding shares of Service Inter Industrie ("SII"), an aerospace component supplier based in Marignane, France. SII specializes in precision machining of critical components used in the manufacture of civil and military helicopters as well as components for the fixed wing commercial and defense aerospace markets. SII is in close proximity to its major customers, whom it serves for the serial production as well as maintenance, repair and overhaul services on select parts. The acquisition of SII provides a new growth vehicle for Magellan and is its first business acquired in France, close to major Airbus operations.

Magellan announced on January 13, 2020 an agreement with Collins Aerospace Systems for the supply of nose landing gear assemblies for the B737 aircraft. The assemblies comprised of complex machined titanium components will be delivered through 2024 from Magellan's facility in Kitchener, Ontario. In order to provide the best solution for Collins Aerospace Systems, Magellan's vertically integrated deliverable will utilize its global resources in Ontario, New York, India, and Poland.

### Labour Matters

The Corporation employs over 4,200 employees; of these, approximately 1,600 are unionized and are covered by 16 collective bargaining agreements as of December 31, 2019. The Corporation maintains constructive relationships with its unions and strives to achieve mutually beneficially relationships while maintaining cost competiveness when negotiating extensions of expiry dates or renewals of the collective agreements. The Corporation is currently in negotiations regarding a number of such extensions or renewals and it expects all negotiations will result in extensions of expiry dates, renewals of the agreements or some other mutually satisfactory agreement as applicable.

### Financing Matters

On September 13, 2018 the Corporation entered into the Bank Credit Facility Agreement, with a syndicate of lenders. The Bank Credit Facility Agreement provides for a multi-currency global operating credit facility to be available to Magellan in a maximum aggregate amount of $75 million. The Bank Credit Facility Agreement also includes a $75 million uncommitted accordion provision, which provides Magellan with the option to increase the size of the operating credit facility to $150 million. Under the terms of the Bank Credit Facility Agreement, the operating credit facility expires on September 13, 2021. Any extensions of the operating credit facility are subject to mutual consent of the lenders and the Corporation.

## 2. OUTLOOK

The outlook for Magellan's business in 2020

Growth in the global commercial aerospace market is expected to continue through 2020; however, forecasters are highlighting several areas to be watched. The air traffic growth rate slowed to 4.2% in 2019 compared to an annual average of 6.2% experienced between 2009 and 2018. Slower air traffic growth could have a tempering effect on the current up cycle. As the single-aisle aircraft represents the largest segment within this market, the timing of Boeing's 737 MAX return-to-service and production restart is an important factor in the overall outlook. Finally, a weakness in demand for wide-body aircraft appears to be signaling a reset for that market segment.

Both Boeing and Airbus closed 2019 with lower order backlogs than the prior year. Boeing closed with a backlog of 5,625 aircraft, a net decrease of 326 aircraft. Airbus closed with a backlog of 7,482 aircraft, a net decrease of 95 aircraft.

The single-aisle market saw Boeing cut the 737 production rate in early second quarter of 2019 from 52 aircraft per month to 42 per month and then in December 2019 Boeing announced that it would pause production starting in January 2020. There are approximately 400 undelivered 737 MAX aircraft parked on the ground and another 387 delivered aircraft that need to be returned to service once authorization has been given by the regulators. In its latest statement, Boeing estimated that the ungrounding would begin during mid-2020.

Boeing's competitor Airbus is currently building its single-aisle A320 aircraft at a rate of 59 aircraft per month which is lower than the 63 aircraft per month that was planned for by the fourth quarter of 2019. The higher rate is now expected to begin by the end of 2020.

The wide-body aircraft market is weak. Responding to a low order intake, Boeing will reduce its 787 aircraft build rate from 14 aircraft per month to 12 aircraft per month late in 2020. In February 2019, Airbus announced that it would wind down the A380 program following the cancellation of orders by the program's largest customer, Emirates. The program will officially cease production in 2020. Several new wide-body programs experienced setbacks in 2019 including Boeing's 777-8 aircraft, which is on hold until 2021. Their 777-9 program and Airbus' A330neo were both delayed in 2019 due to engine issues. Production of the A350 aircraft has dropped from 9.8 aircraft per month to 9.4 aircraft per month for the next few years. A new threat to the wide-body market is the success of Airbus' new A321XLR long range aircraft that was launched in June 2019 in Paris. With the A321XLR model, airlines will be able to operate a lower-cost single-aisle aircraft on longer and less heavily travelled routes, many of which can now only be served by larger and less efficient wide-body aircraft.

In the regional jet market, the A220 aircraft backlog has increased strongly since Airbus assumed ownership of the program from Bombardier. Their new Alabama facility is slated to deliver up to 4 aircraft per month with Canadian facilities having a capacity to deliver up to 10 aircraft per month. The Boeing/Embraer commercial aircraft division deal was expected to close by the end of 2019, but due to unexpected European Union regulatory delays, completion is now pushed into the first quarter of 2020. Embraer achieved the first flight of its new E175-E2 in December 2019. The other two aircraft in the series, the E190-E2 and E195-E2, are both performing well with order backlogs of around 44 and 124 aircraft respectively. In 2019, Mitsubishi acquired Bombardier's CRJ regional jet operations. Their domestic MRJ program now rebranded as SpaceJet has been plagued with delays. The program had orders for 490 aircraft at the end of 2019. The first delivery of the M90 is expected in 2020 with the M100 planned for 2023.

In the regional turboprop market, ATR continues to hold the strongest position with an order backlog at the end of 2019 of 486 ATR 42's and 1,234 ATR 72's. Comparatively, De Havilland Canada closed 2019 with a Q400 order backlog of approximately 45 aircraft.

Business jet deliveries were 10% higher in 2019 compared to 2018, a growth driven primarily by new products introduced to stimulate demand. According to Forecast International, this market is expected to grow modestly in 2020 and then decline in 2021 and 2022 before resuming growth in 2023.

Flight International has stated that worldwide defence spending will grow by 3% to 4% in 2020 and by 3% annually through at least 2023 due to increasing global security concerns. In the United States, the Government's fiscal year 2020 Defense Appropriations Bill, which was approved last December, increased spending by US$18.9 billion over fiscal year 2019. Some key programs benefiting from this bill were F-35 and F/A-18E/F fighters, UH-60 Blackhawk and AH-64 Apache helicopters, KC-46 Tankers and C130J transport aircraft.

Lockheed Martin's F-35 Fighter Program achieved a number of key milestones in 2019 including the delivery of 134 aircraft, 3 aircraft ahead of plan, and reduced the F-35A price to $77.9 million, which was ahead of the $80 million goal, one year earlier than planned. In 2020 Lockheed plans to deliver 141 F-35's while preparing to increase volume year-over-year to reach a peak of around 170 aircraft in 2022, as demand for the aircraft remains strong for the U.S. Department of Defense and international customers. There are currently more than 490 aircraft operating from 21 bases in eight nations around the globe.

Canada's Future Fighter replacement program has three competitors remaining in the $19.0 billion contest: Lockheed Martin with its F-35; Boeing with the Super Hornet; and Saab, which is offering an updated version of its Gripen fighter. Proposals are due to the Canadian Government by June 30, 2020. A down selection is expected in 2020 or 2021 followed by the identification of the selected bidder in early 2022 and first aircraft delivery planned in 2025.

## 3. SELECTED ANNUAL INFORMATION

A summary of selected annual financial information for 2019, 2018 and 2017

| Expressed in millions of dollars, except per share information | **2019** | 2018 | 2017 (restated)[1] |
|---|---|---|---|
| Revenues | **1,016.2** | 966.8 | 955.5 |
| Net income for the year | **67.4** | 89.1 | 109.5 |
| Net income per common share – Basic and Diluted | **1.16** | 1.53 | 1.88 |
| EBITDA | **145.2** | 162.1 | 178.3 |
| EBITDA per common share – Basic and Diluted | **2.49** | 2.78 | 3.06 |
| Total assets | **1,141.2** | 1,072.9 | 982.7 |
| Total non-current financial liabilities | **125.2** | 86.4 | 77.3 |

[1] *Restated upon adoption of IFRS 15, Revenue from Contracts with Customers.*

Revenues for the year ended December 31, 2019 increased from both 2018 and 2017 levels. The increase in revenues from 2018 was primarily attributable to volume increases in repair and overhaul services, proprietary and casting products. Net income decreased in 2019 from 2018 mainly due to lower gross margin as a result of lower production volumes on certain programs, production inefficiencies in certain of our operating divisions and higher manufacturing costs, and the costs incurred for the implementation of a new ERP program. In addition, a net gain related to prior acquisitions was recorded in 2018 (See "Results of Operations").

During 2019 the Corporation paid quarterly dividends on common shares of $0.10 per share for the first three quarters and $0.105 per share in the fourth quarter, amounting to $23.6 million in total for the year. During 2018, the Corporation paid quarterly dividends on common shares of $0.085 per share in the first three quarters and $0.10 per share in the fourth quarter, amounting to $20.7 million in total for the year.

## 4. RESULTS OF OPERATIONS

A discussion of Magellan's operating results for 2019 and 2018

### Consolidated Revenues

Consolidated revenues for the year ended December 31, 2019 were $1,016.2 million, a 5.1% increase from the $966.8 million last year. Gross profit and net income were $157.0 million and $67.4 million, respectively, in comparison to gross profit of $163.3 million and net income of $89.1 million for the year ended December 31, 2018.

| Twelve-months ended December 31, expressed in thousand of dollars | **2019** | 2018 | Change |
|---|---|---|---|
| Canada | **366,565** | 320,838 | 14.3% |
| United States | **322,970** | 325,739 | (0.9%) |
| Europe | **326,684** | 320,176 | 2.0% |
| **Total revenues** | **1,016,219** | 966,753 | 5.1% |

Consolidated revenues are impacted by the fluctuation of the United States dollar and British pound against the Canadian dollar when the Corporation translates its foreign operations to Canadian dollars. Further, the fluctuation of the British pound relative to the United States dollar impacts the performance of the Corporation's European operations. If the average exchange rates for both the United States dollar and British pound experienced in 2018 remained constant in 2019, consolidated revenues for 2019 would have been approximately $998.8 million.

On a currency neutral basis, in comparison to 2018, revenues in Canada in 2019 increased 12.6% primarily driven by higher volumes in repair and overhaul services, proprietary and casting products. Revenues in the United States decreased by 3.1% largely due to volume decreases for single aisle aircraft and aeroengine programs, offset by higher spare sales. Revenues in Europe increased slightly by 0.5% from the prior year.

### Gross Profit

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 | Change |
|---|---|---|---|
| Gross Profit | **156,958** | 163,275 | (3.9%) |
| Percentage of revenue | **15.4%** | 16.9% | |

Gross profit was $157.0 million in 2019, $6.3 million lower than 2018 of $163.3 million. Gross profit, as a percentage of revenues was lower than the prior year by 1.5%. Decrease in gross profit was primarily driven by lower production volumes on certain programs, production inefficiencies in certain of our operating divisions, higher manufacturing costs and an accrual recorded in relation to the wind-down of the A380 program, offset in part by higher volumes in repair and overhaul services and proprietary products and the favourable foreign exchange due to the strengthening year over year of the United States dollar against the Canadian dollar and the British pound.

### Administrative and General Expenses

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 | Change |
|---|---|---|---|
| Administrative and general expenses | **62,312** | 57,337 | 8.7% |
| Percentage of revenue | **6.1%** | 5.9% | |

Administrative and general expenses as a percentage of revenue were 6.1% in 2019 as compared to 5.9% in 2018. Administrative and general expenses of $62.3 million in 2019 were $5.0 million or 8.7% higher than $57.3 million in the prior year mainly due to costs incurred by the Corporation for its phased implementation of a new ERP program, higher repair and maintenance costs in its new Mississauga facility, and increased costs in relation to acquisitions in 2019. In addition, $0.5 million was recorded in other income in 2018 as a result of an early termination of a rental agreement.

### Other

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Foreign exchange loss (gain) | **1,874** | (2,993) |
| Loss on disposal of property, plant and equipment | **32** | 313 |
| Other | **3,112** | (9,676) |
| **Other** | **5,018** | (12,356) |

Included in other income is a foreign exchange loss of $1.9 million compared to a gain of $3.0 million in the prior year. The movements in balances denominated in foreign currencies and the fluctuations of the foreign exchange rates impact the net foreign exchange loss or gain recorded during the year. In 2019, $4.0 million of one-time relocation expenses were incurred for the Corporation's new Mississauga facility on its relocation to a new operating plant, offset by a $0.9 million gain recorded in relation to the step acquisition of one of its joint ventures in India. In 2018, the Corporation recognized a net gain of $9.7 million in relation to prior acquisitions.

### Interest Expense

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Interest on bank indebtedness and long-term debt | **101** | 884 |
| Accretion charge on long-term debt and borrowings | **1,091** | 1,006 |
| Accretion charge for lease liabilities | **1,387** | – |
| Discount on sale of trade receivables | **2,053** | 2,224 |
| **Interest expense** | **4,632** | 4,144 |

Total interest costs of $4.6 million for 2019 increased by $0.5 million from $4.1 million in 2018, primarily due to accretion charge for lease liabilities recorded as a result of adopting IFRS 16, *Leases* effective January 1, 2019, offset by decreased interest on bank indebtedness and long-term debt attributed to reduced principal amounts outstanding during the year.

### Income Taxes

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Current income tax expense | **6,105** | 9,402 |
| Deferred income tax expense | **11,510** | 15,658 |
| **Income tax expense** | **17,615** | 25,060 |
| **Effective tax rate** | **20.7%** | 21.9% |

The Corporation recorded an income tax expense in 2019 of $17.6 million on pre-tax income of $85.0 million, representing an effective tax rate of 20.7%, compared to an income tax expense of $25.1 million on a pre-tax income of $114.2 million in 2018.

During 2019 and 2018, the Corporation recognized investment tax credits totalling $4.8 million and $10.0 million, respectively, as a reduction of cost of revenues, as the Corporation has determined that it will be able to benefit from these investment tax credits. The change in mix of income across the different jurisdictions in which the Corporation operates also impacts the change in the effective tax rate.

## 5. RECONCILIATION OF NET INCOME TO EBITDA

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

In addition to the primary measures of earnings and earnings per share (basic and diluted) in accordance with IFRS, the Corporation includes EBITDA (earnings before interest, income taxes and depreciation and amortization) in this MD&A. The Corporation has provided this measure because it believes this information is used by certain investors to assess financial performance and that EBITDA is a useful supplemental measure as it provides an indication of the results generated by the Corporation's principal business activities prior to consideration of how these activities are financed and how the results are taxed in the various jurisdictions. Each component of this measure is calculated in accordance with IFRS, but EBITDA is not a recognized measure under IFRS, and the Corporation's method of calculation may not be comparable with that of other companies. Accordingly, EBITDA should not be used as an alternative to net income as determined in accordance with IFRS or as an alternative to cash provided by or used in operations.

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Net income | **67,381** | 89,120 |
| Interest | **4,632** | 4,114 |
| Taxes | **17,615** | 25,060 |
| Depreciation and amortization | **55,593** | 43,809 |
| **EBITDA** | **145,221** | 162,103 |

EBITDA for the year ended 2019 of $145.2 million decreased by $16.9 million when compared to $162.1 million in 2018, primarily as a result of lower net income due to a one-time gain recorded in 2018 and lower taxes, offset by higher interest, and depreciation and amortization expenses mainly due to the implementation of the new lease standard.

## 6. SELECTED QUARTERLY FINANCIAL INFORMATION

A summary view of Magellan's quarterly financial performance

| Expressed in millions of dollars except per share information | | | | **2019** | | | | 2018 |
|---|---|---|---|---|---|---|---|---|
| | **Mar 31** | **Jun 30** | **Sep 30** | **Dec 31** | Mar 31 | Jun 30 | Sep 30 | Dec 31 |
| Revenues | **269.9** | **264.1** | **235.6** | **246.7** | 244.6 | 241.2 | 226.5 | 254.5 |
| Income before taxes | **25.9** | **27.8** | **19.6** | **11.7** | 22.5 | 29.8 | 23.4 | 38.5 |
| Net income | **20.4** | **21.7** | **15.8** | **9.4** | 17.5 | 23.5 | 18.6 | 29.5 |
| Net income per common share | | | | | | | | |
| Basic and Diluted | **0.35** | **0.37** | **0.27** | **0.16** | 0.30 | 0.40 | 0.32 | 0.51 |
| EBITDA[1] | **40.5** | **42.7** | **34.1** | **27.9** | 34.1 | 41.8 | 35.5 | 50.7 |

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

Revenues and net income reported in the table above were impacted by the movements in the Canadian dollar relative to the United States dollar and British pound when the Corporation translates its foreign operations to Canadian dollars. Further, the movements in the United States dollar relative to British pound impact the Corporation's United States dollar exposures in its European operations. During the periods reported, the average exchange rate of the United States dollar relative to the Canadian dollar fluctuated between a high of 1.3375 in the second quarter of 2019 and a low of 1.2648 in the first quarter of 2018. The average exchange rate of the British pound relative to the Canadian dollar moved from a high of 1.7607 in the first quarter of 2018 to a low of 1.6280 in the third quarter of 2019. The average exchange rate of the British pound relative to the United States dollar reached its high of 1.3920 in the first quarter of 2018 and hit a low of 1.2327 in the third quarter of 2019. Had exchange rates remained at levels experienced in 2018, reported revenues in 2019 would have been lower by $10.3 million, $6.2 million and $1.2 million for the first three quarters respectively; higher by $0.3 million in the fourth quarter.

As discussed above, net income reported in the quarterly information was also impacted by the foreign exchange movements. In the fourth quarter of 2018, the Corporation recorded a net gain of $9.7 million related to prior acquisitions. The fourth quarter of 2019 was impacted by volume decrease in Europe, production inefficiencies in certain of our operating divisions and an accrual recorded in relation to the wind-down of the A380 program.

## 7. LIQUIDITY AND CAPITAL RESOURCES

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

The Corporation's liquidity needs can be met through a variety of sources including cash on hand, cash provided by operations, short-term borrowings from its credit facility and trade receivables securitization program, and long-term debt and equity capacity. Principal uses of cash are to fund liabilities as they become due, finance capital expenditures, fund debt repayments, pay dividends and provide flexibility for new investment opportunities. Based on current funds available and expected cash flow from operating activities, management believes that the Corporation has sufficient funds available to meet its liquidity requirements at any point in time. However, if cash from operating activities is lower than expected or capital costs for projects exceed current estimates, or if the Corporation incurs major unanticipated expenses, it may be required to seek additional capital in the form of debt or equity or a combination of both.

In 2019, $104.2 million of cash was generated by operations, $62.3 million was used in investing activities and $34.2 million was used in financing activities.

### Cash Flow from Operating Activities

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Decrease (increase) in account receivables | **12,183** | (13,224) |
| Increase in contract assets | **(12,870)** | (18,335) |
| (Increase) decrease in inventories | **(21,096)** | 1,868 |
| Increase in prepaid expenses and other | **(1,124)** | (5,412) |
| Decrease in accounts payable, accrued liabilities and provisions | **(3,974)** | (6,046) |
| **Net change in non-cash working capital items** | **(26,881)** | (41,149) |
| **Net cash provided by operating activities** | **104,205** | 99,997 |

The Corporation generated $104.2 million in 2019 from operating activities, compared to $100.0 million in the prior year. Changes in non-cash working capital items used cash of $26.9 million, $14.3 million lower when compared to $41.1 million in the prior year, largely attributed to the decrease in account receivables, higher contract assets resulted from the timing of production and billing related to products transferred over time, the increase in prepaid expenses and the decrease in accounts payable, accrued liabilities and provisions due to timing of payment, offset by the increase in inventories related to timing of purchase and production and to support higher production volumes in a number of programs in 2020.

### Cash Flow from Investing Activities

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Business combinations | **(5,519)** | – |
| Purchase of property, plant and equipment | **(51,820)** | (48,346) |
| Proceeds from disposal of property, plant and equiptment | **388** | 411 |
| Change in restricted cash | **–** | 3,329 |
| Increase in intangibles and other assets | **(5,301)** | (2,728) |
| **Net cash used in investing activities** | **(62,252)** | (47,334) |

Investing activities for 2019 used $62.3 million compared to $47.3 million in the prior year, an increase of $15.0 million mainly related to acquisitions of new businesses, higher level of investment in capital assets, and the investment in ERP system. The Corporation invested $51.8 million in capital assets during the year in comparison to $48.3 million in 2018. The Corporation continues to invest in advanced technology production equipment and information technology systems, both designed to increase productivity, reduce cycle time and improve technology capability.

### Cash Flow from Financing Activities

| Twelve-months ended December 31, expressed in thousands of dollars | **2019** | 2018 |
|---|---|---|
| Decrease in bank indebtedness | **–** | (264) |
| (Decrease) increase in debt due within one year | **(1,720)** | 3,892 |
| Decrease in long-term debt | **(4,124)** | (15,165) |
| Lease liability payments | **(3,972)** | – |
| Decrease in long-term liabilities and provisions | **(44)** | (945) |
| (Decrease) increase in borrowings, net | **(803)** | 1,302 |
| Common share dividend | **(23,575)** | (20,664) |
| **Net cash used in financing activities** | **(34,238)** | (31,844) |

The Corporation used $34.2 million in 2019 mainly to repay long-term debt and debt due within one year, and pay lease liabilities and dividends.

### Contractual Obligations

| As at December 31, 2019, expressed in thousands of dollars | **Less than 1 year** | **1-3 Years** | **4-5 Years** | **After 5 Years** | **Total** |
|---|---|---|---|---|---|
| Trade receivables securitization | 39,399 | – | – | – | 39,399 |
| Long-term debt | 2,473 | 4,452 | 2,880 | – | 9,805 |
| Lease liabilities | 6,649 | 11,971 | 10,404 | 30,523 | 59,547 |
| Other long-term liabilities | 152 | 509 | 252 | 888 | 1,801 |
| Borrowings subject to specific conditions | 1,193 | 1,565 | 1,608 | 20,925 | 25,291 |
| **Total Contractual Obligations** | **49,866** | **18,497** | **15,144** | **52,336** | **135,843** |

Major cash flow requirements for 2019 include the repayment of trade receivables securitization of $39.4 million which is expected to be refinanced, repayment of long-term debt of $2.5 million, payments of lease liabilities of $6.6 million and borrowings subject to specific conditions of $1.2 million.

The Corporation has a Bank Credit Facility Agreement with a syndicate of lenders. The Bank Credit Facility Agreement provides for a multi-currency global operating credit facility to be available to Magellan in a maximum aggregate amount of $75 million. The Bank Credit Facility Agreement also includes a $75 million uncommitted accordion provision, which provides Magellan with the option to increase the size of the operating credit facility to $150 million. Under the terms of the Bank Credit Facility Agreement, the operating credit facility expires on September 13, 2021. Any extensions of the operating credit facility are subject to mutual consent of the lenders and the Corporation.

As at December 31, 2019, the Corporation had made contractual commitments to purchase $8.5 million of capital assets. In addition, the Corporation had purchase commitments, largely for materials required for the normal course of operations, of $303.0 million as at December 31, 2019. The Corporation plans to fund all of these commitments with operating cash flow and the existing credit facility.

**Outstanding Share Information**

The authorized capital of the Corporation consists of an unlimited number of preference shares, issuable in series, and an unlimited number of common shares. As at March 6, 2020, 58,209,001 common shares were outstanding and no preference shares were outstanding. More information on the Corporation's share capital is provided in note 20 of the Corporation's consolidated financial statements.

On March 29, 2019, June 28, 2019, and September 30, 2019 the Corporation paid quarterly dividends on its 58,209,001 common shares of $0.10 per common share, representing an aggregate dividend payment of $17.5 million. On December 31, 2019 the Corporation paid quarterly dividends on its 58,209,001 common shares of $0.105 per common share, amounting to $6.1 million.

For the year ended December 31, 2018, the Corporation declared and paid dividends on its common shares on March 30, 2018, June 29, 2018, and September 28, 2018 of $0.085 per share amounting to $14.9 million and on December 31, 2018 of $0.10 per share amounting to $5.8 million.

In the first quarter of 2020, the Corporation declared cash dividends of $0.105 per common share payable on March 31, 2020 to shareholders of record at the close of business on March 20, 2020.

## 8. FINANCIAL INSTRUMENTS

A summary of Magellan's financial instruments

**Derivative Contracts**

The Corporation operates internationally, which gives rise to a risk that its income, cash flows and shareholders' equity may be adversely impacted by fluctuations in foreign exchange rates. Currency risk arises because the amount of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rates and because the non-Canadian dollar denominated financial statements of the Corporation's subsidiaries may vary on consolidation into the reporting currency of Canadian dollars. The Corporation from time to time may use derivative financial instruments to help manage foreign exchange risk with the objective of reducing transaction exposures and the resulting volatility of the Corporation's earnings. The Corporation does not trade in derivatives for speculative purposes. Under these contracts the Corporation is obligated to purchase specified amounts at predetermined dates and exchange rates. These contracts are matched with anticipated cash flows in United States dollars. The counterparties to the foreign currency contracts are all major financial institutions with high credit ratings. As at December 31, 2019, there were no foreign exchange contracts outstanding.

### Off-Balance Sheet Arrangements

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

## 9. RELATED PARTY TRANSACTIONS

A summary of Magellan's transactions with related parties

During the year, the Corporation incurred consulting and cost recovery fees of $0.2 million [2018 – $0.1 million] payable to a corporation controlled by the Chairman of the Board of Directors of the Corporation.

## 10. RISK FACTORS

A summary of risks and uncertainties facing Magellan

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 help monitor, manage, and mitigate these risks. Additional risks and uncertainties not presently known by the Corporation, or that the Corporation does not currently anticipate, may be material and may impair the Corporation's performance.

The following risks and uncertainties apply to the Corporation. Information relating to additional risks and uncertainties are set forth in the Corporation's Annual Information Form on SEDAR at www.sedar.com.

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

The Corporation's gross profit is derived from the aerospace industry. The Corporation's aerospace operations are focused on engineering and manufacturing aircraft components for new manufactured aircraft, and 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 possible changes in sourcing strategies by aircraft operators and OEMs, decreased demand for air travel or projected market growth that may not materialize or be sustainable. Although fuel prices have remained low, since it is a significant cost factor for aircraft operators, any sizeable price increases can affect their operating margins and reduce their ability to finance capital expenditures. Constraints in the credit market may reduce the ability of airlines and others to purchase new aircraft, negatively affecting the demand for the Corporation's products. 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 and external to the aerospace industry might affect the aerospace industry and may have an adverse impact on the Corporation's results of operations. More specifically, a number of additional external risk factors may include the financial condition of the airline industry, commercial aerospace customers and government aerospace customers; government policies related to import and export restrictions and business acquisitions; changing priorities and possible spending cuts by government agencies; government support for export sales; world trade policies; increased competition from other businesses, including new entrants in market segments in which the Corporation competes. In addition, acts of terrorism, natural disasters, global health risks, political instability or the outbreak of war or continued hostilities in certain regions of the world could result in lower orders or the rescheduling or cancellation of part of the existing order backlog for some of the Corporation's products. In particular, the uncertainties arising from a contagious illnesses, such as the coronavirus currently impacting China and other geographies, could adversely impact global travel and potentially impact aircraft delivery rates of the Corporation's customers.

*Political uncertainty could result in a decrease in revenues or have other material adverse effects on the Corporation.*

Significant political events can cast uncertainty on global financial and economic markets and depending upon the nature of the event can directly affect the aerospace market. One example is the renegotiation of the "USMCA" (United States-Mexico-Canada Agreement, formerly NAFTA) and the potential for significant U.S. import tariffs being levied on aerospace materials produced outside of the United States. New tax legislation or changes to existing tax laws, as well as the potential introduction of laws to reduce immigration and restrict access into the United States for citizens of certain countries could also present future challenges to non-U.S. corporations.

Britain officially exited the European Union on January 31, 2020 ("Brexit") and now faces the process of negotiating new trade agreements with European and other countries. Until these negotiations are concluded, economic uncertainty may drive volatility in the value of the British pound. Any long term impact from Brexit on Magellan's United Kingdom operations will depend, in part, on the outcome of tariff, trade, regulatory, and other negotiations. Whether or not listed above, any effects of Brexit, may have a negative effect and may adversely affect the Corporation's business.

To the extent that certain political actions taken in North America, Europe and elsewhere in the world result in a marked decrease in free trade, access to personnel and freedom of movement it could have an adverse effect on the Corporation's ability to market its products and services internationally, increase costs for goods and services required for the Corporation's operations, reduce access to skilled labour and negatively impact the Corporation's business, operations, financial conditions and the market value of its Common Shares.

*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. As 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 and contagious illness outbreaks such as the coronavirus outbreak currently impacting a number of countries and forecasted to spread on a global basis. 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.

*Competitive pressures may adversely affect the Corporation.*

The Corporation competes in the aerospace industry primarily in support of 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 and name recognition are substantially greater than that of the Corporation and this constitutes significant competitive advantages. There can be no assurance that Magellan will be able to compete successfully against current and future competitors or that the competitive pressures that Magellan faces will not adversely affect the Corporation's operating revenues and, in turn, the Corporation's business and financial condition.

The aerospace and defence industry continues to experience consolidation through mergers and acquisitions and vertical integration strategies. This trend also affects the Corporation's customers, competitors and suppliers. Consolidation among Magellan's customers may result in delays in awarding new contracts and losses of existing business. Consolidation among the Corporation's competitors may result in larger competitors with greater resources and market share leverage, which could adversely affect the Corporation's ability to compete successfully. Consolidation among Magellan's suppliers may result in fewer sources of supply and increased costs to the Corporation.

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

The Corporation's financial results are reported in Canadian dollars, though a large portion of the Corporation's revenues and expenses are in foreign currencies, primarily US dollars or British pounds. It is expected that some revenues and expenses will continue to be based in foreign currencies. In situations where the Corporation is not fully hedged, fluctuations in the Canadian dollar exchange rate to foreign currencies will impact the Corporation's results of operations and financial condition from period to period. In addition, such fluctuations could affect the translation of the Corporation's results and profitability shown in its consolidated financial statements. The Corporation also may not be able to manage its currency exposure on commercially reasonable terms.

## 11. CRITICAL ACCOUNTING ESTIMATES

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

The preparation of consolidated financial statements requires management to make critical judgements, estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses recorded during the reporting period. The critical estimates and judgements utilized in preparing the Corporation's consolidated financial statements affect the assessment of net recoverable amounts, net realizable values and fair values, depreciation and amortization rates and useful lives, value of intangible assets, ability to utilize tax losses and other tax measurements, determination of functional currency, determination of the degree of control that exists in determining the corresponding accounting basis, and the selection of accounting policies. Any changes in estimates and assumptions could have a material impact on the Corporation's future income and/or the amounts reported in its statement of financial position. The Corporation reviews its estimates and assumptions on an ongoing basis and uses the most current information available and exercises careful judgement in making these estimates and assumptions.

The main assumptions and estimates that were used in preparing the Corporation's consolidated financial statements relate to:

*Financial instruments*
The valuation of the Corporation's derivative instruments and certain other financial instruments requires estimation of the fair value of each instrument at the reporting date. Details of the basis on which fair value is estimated are provided in note 22 to the consolidated financial statements.

*Impairments*
The recoverable amount of intangible assets and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each cash generating unit ("CGU") or group of CGUs.

In order to estimate the fair value of indefinite-lived intangible assets and goodwill resulting from business combinations, the Corporation typically estimates future revenue, considers market factors and estimates future cash flows. Based on these key assumptions, judgments and estimates, the Corporation determines whether to record an impairment charge to reduce the value of the asset carried on the consolidated statements of financial position to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Corporation's business strategy or internal forecasts. Although the Corporation believes the assumptions, judgments and estimates made in the past have been reasonable and appropriate, different assumptions, judgments and estimates could materially affect the Corporation's reported financial results.

*Deferred taxes*
Income taxes are determined based on estimates of the Corporation's current income taxes and estimates of deferred income taxes resulting from temporary differences. Deferred tax assets are assessed to determine the likelihood that they will be realized from future taxable income before they expire.

*Government assistance*
Investment tax credits and scientific research and experimental development tax credits are determined based on estimates of the Corporation's current year expenditures on qualifying programs. The investment tax credits are assessed to determine the likelihood that they will be applied against federal income taxes.

*Capitalization of development costs*
When capitalizing development costs the Corporation must assess the technical and commercial feasibility of the projects and estimate the useful lives of resulting products. Determining whether future economic benefits will flow from the assets and therefore the estimates and assumptions associated with these calculations are instrumental in (i) deciding whether project costs can be capitalized, and (ii) accurately calculating the useful life of the projects for the Corporation.

*Leases*
The Corporation determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend or terminate the lease. The lease term is estimated by considering the facts and circumstances that can create an economic incentive to exercise an extension option, or not exercise the termination option. Both qualitative and quantitative assumptions are considered when deriving the value of the economic incentive.

The Corporation makes judgments in determining whether a contract contains an identified asset. The identified asset should be physically distinct or represent substantially all of the capacity of the asset, and should provide the Corporation with the right to substantially all of the economic benefits from the use of the asset.

Judgments are made by the Corporation in determining the incremental borrowing rate used to measure the lease liability for each lease contract, including an estimate of the asset-specific security impact. The incremental borrowing rate should reflect the interest rate that the Corporation would have to pay to borrow at a similar term and with a similar security.

*Income (loss) on completion of contracts*
To estimate income (loss) on completion, the Corporation takes into account factors inherent to the contract by using historical and/or forecast data.

*Repayable government grants*

The forecast repayment of grants received from government authorities is based on future sales. As the forecast repayments are closely related to forecasts of future sales set out in business plans prepared by the operating divisions, the estimates and assumptions underlying these business plans are instrumental in determining the timing of these repayments.

*Employee benefits*

The Corporation considers a number of factors in developing the pension assumptions, including an evaluation of relevant discount rates, plan asset allocations, mortality, expected changes in wages and retirement benefits, analysis of current market conditions, economic benefits available and input from actuaries and other consultants. Costs of the programs are based on actuarially determined amounts and are accrued over the period from the date of hire to the full eligibility date of employees who are expected to qualify for these benefits.

## 12. CHANGES IN ACCOUNTING POLICIES

A description of accounting standards adopted in 2019

The Corporation has adopted the following new and amended standards in 2019.

**IFRS 16 Leases**

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

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

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

For leases that were classified as operating leases under IAS 17, lease liabilities at transition have been measured at the present value of remaining lease payments, discounted at the incremental borrowing rate as at January 1, 2019. Right-of-use assets at transition have been measured at an amount equal to the corresponding lease liabilities, adjusted for any prepaid or accrued rent relating to that lease. The weighted average discount rate applied to the total lease liabilities recognized on transition was 3.82%.

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

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

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

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

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

**Uncertainty over Income Tax Treatments**

In June 2017, IASB issued IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments* ("IFRIC 23"), which clarifies application of recognition and measurement requirements in IAS 12, *Income Taxes* when there is uncertainty over income tax treatments. IFRIC 23 is effective for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted. The adoption of IFRIC 23 has no impact on the Corporation's consolidated financial statements.

**Amendments to IAS 19 Plan Amendment, Curtailment or Settlement**

In February 2018, the IASB issued amendments to IAS 19, *Employee Benefits* ("IAS 19") which address the accounting for plan amendments, curtailments or settlements during the reporting period. The amendments to IAS 19 require an entity to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and to recognize in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognized because of the impact of the asset ceiling. The amendments apply to plan amendments, curtailments or settlements that occur on or after January 1, 2019, with earlier application permitted. The amendments will have an impact on the Corporation's consolidated financial statements when there are plan amendments, curtailments or settlements after the effective date.

**Annual Improvements to IFRS Standards 2015 – 2017**

In December 2017, IASB issued the following amendments from the 2015-2017 annual improvement cycle.

*IFRS 3 Business Combination*

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019. Earlier application is permitted. These amendments will apply on business combinations of the Corporation after January 1, 2019.

*IAS 12 Income Taxes*

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events. An entity applies those amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognized on or after the beginning of the earliest comparative period. The Corporation does not expect these amendments will have an impact on the Corporation's consolidated financial statements.

## 13. CONTROLS AND PROCEDURES

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

Based on the current Canadian Securities Administrators (the "CSA") rules under National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings,* the Chief Executive Officer and Chief Financial Officer are required to certify as at December 31, 2019 that they are responsible for establishing and maintaining, and have assessed the design and operating effectiveness of disclosure controls and procedures and internal control over financial reporting.

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

In preparation for this certification, Magellan has dedicated resources in place to document and evaluate the design and operating effectiveness of disclosure controls and procedures and internal control over financial reporting. As of December 31, 2019, an evaluation was carried out, under the supervision of the President and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Corporation's disclosure controls and internal controls over financial reporting, as those terms are defined in National Instrument 52-109. Based on that evaluation, the Corporation's management concluded that the Corporation's design and operating disclosure controls and procedures and internal control over financial reporting were effective as of December 31, 2019.

No changes were made in the Corporation's internal control over financial reporting during the year ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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

## MANAGEMENT'S REPORT

December 31, 2019

**To the shareholders of Magellan Aerospace Corporation**

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 of Directors approved the consolidated financial statements.

Phillip C. Underwood
*President and Chief Executive Officer*
March 6, 2020

Elena M. Milantoni
*Chief Financial Officer*

## INDEPENDENT AUDITORS' REPORT

December 31, 2019

To the Shareholders of Magellan Aerospace Corporation

**Opinion**

We have audited the consolidated financial statements of Magellan Aerospace Corporation and its subsidiaries (the Group), which comprise the consolidated statements of financial position as at December 31, 2019 and 2018, and the consolidated statements of income and comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended December 31, 2019 and 2018, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2019 and 2018, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2019 and 2018 in accordance with International Financial Reporting Standards (IFRS).

**Basis for opinion**

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Other information**

Management is responsible for the other information. The other information comprises:

– Management's Discussion and Analysis
– The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis and the Annual Report prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

**Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Stephanie Lamont.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
March 6, 2020

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| Expressed in thousands of Canadian dollars | Notes | **December 31 2019** | December 31 2018 |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalent | 3 | **69,637** | 63,316 |
| Trade and other receivables | 4 | **177,801** | 187,897 |
| Contract assets | 5 | **77,967** | 66,436 |
| Inventories | 6 | **196,823** | 175,082 |
| Prepaid expenses and other | | **21,127** | 20,058 |
| | | **543,355** | 512,789 |
| **Non-current assets** | | | |
| Property, plant and equipment | 7 | **439,102** | 428,878 |
| Right-of-use assets | 8 | **44,692** | – |
| Investment properties | 9 | **2,180** | 2,305 |
| Intangible assets | 10 | **65,373** | 62,745 |
| Goodwill | 10 | **34,137** | 35,104 |
| Other assets | 11, 23 | **8,770** | 19,666 |
| Deferred tax assets | 19 | **3,556** | 11,393 |
| | | **597,810** | 560,091 |
| **Total assets** | | **1,141,165** | 1,072,880 |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities and provisions | 13 | **151,907** | 154,407 |
| Debt due within one year | 14, 15, 22 | **48,144** | 44,393 |
| | | **200,051** | 198,800 |
| **Non-current liabilities** | | | |
| Long-term debt | 14 | **6,876** | 9,064 |
| Lease liabilties | 15 | **39,794** | – |
| Borrowings subject to specific conditions | 16 | **24,098** | 24,510 |
| Other long-term liabilities and provisions | 17, 23 | **20,289** | 19,668 |
| Deferred tax liabilities | 19 | **34,181** | 33,165 |
| | | **125,238** | 86,407 |
| **Equity** | | | |
| Share capital | 20 | **254,440** | 254,440 |
| Contributed surplus | | **2,044** | 2,044 |
| Other paid-in capital | | **13,565** | 13,565 |
| Retained earnings | | **516,911** | 473,246 |
| Accumulated other comprehensive income | 28 | **25,539** | 44,378 |
| Equity attributable to equity holders of the Corporation | | **812,499** | 787,673 |
| Non-controlling interest | | **3,377** | – |
| **Total liabilities and equity** | | **1,141,165** | 1,072,880 |

See accompanying notes to the consolidated financial statements

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

| Expressed in thousands of Canadian dollars, except per share amounts | Notes | Years ended December 31<br>**2019** | 2018 |
|---|---|---|---|
| Revenues | 24 | **1,016,219** | 966,753 |
| Cost of revenues | 25 | **859,261** | 803,478 |
| Gross profit | | **156,958** | 163,275 |
| Administrative and general expenses | 26 | **62,312** | 57,337 |
| Other | 11, 31 | **5,018** | (12,356) |
| Income before interest and income taxes | | **89,628** | 118,294 |
| Interest | 27 | **4,632** | 4,114 |
| Income before income taxes | | **84,996** | 114,180 |
| Income taxes | | | |
| Current | 19 | **6,105** | 9,402 |
| Deferred | 19 | **11,510** | 15,658 |
| | | **17,615** | 25,060 |
| **Net income** | | **67,381** | 89,120 |
| Other comprehensive (loss) income | | | |
| Other comprehensive (loss) income that may be reclassified to profit and loss in subsequent periods: | | | |
| Foreign currency translation | 28 | **(18,839)** | 26,171 |
| Items not to be reclassified to profit and loss in subsequent periods: | | | |
| Actuarial loss on defined benefit pension plans, net of taxes | 19, 23 | **(141)** | (5,203) |
| **Comprehensive income** | | **48,401** | 110,088 |
| **Net income per share** | | | |
| Basic | 20 | **1.16** | 1.53 |
| Diluted | 20 | **1.16** | 1.53 |

See accompanying notes to the consolidated financial statements

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| | Attributable to equity holders of corporation | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Expressed in thousands of Canadian dollars | Share capital | Contributed surplus | Other paid in captial | Retained earnings | Foreign currency translation | Total | Non-controlling interest | Total equity |
| January 1, 2018 | 254,440 | 2,044 | 13,565 | 409,993 | 18,207 | 698,249 | – | 698,249 |
| Net income | – | – | – | 89,120 | – | 89,120 | – | 89,120 |
| Other comprehensive (loss) income | – | – | – | (5,203) | 26,171 | 20,968 | – | 20,968 |
| Common share dividend | – | – | – | (20,664) | – | (20,664) | – | (20,664) |
| December 31, 2018 | 254,440 | 2,044 | 13,565 | 473,246 | 44,378 | 787,673 | – | 787,673 |
| Business combination | – | – | – | – | – | – | 3,377 | 3,377 |
| Net income | – | – | – | 67,381 | – | 67,381 | – | 67,381 |
| Other comprehensive loss | – | – | – | (141) | (18,839) | (18,980) | – | (18,980) |
| Common share dividend | – | – | – | (23,575) | – | (23,575) | – | (23,575) |
| **December 31, 2019** | **254,440** | **2,044** | **13,565** | **516,911** | **25,539** | **812,499** | **3,377** | **815,876** |

See accompanying notes to the consolidated financial statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| Expressed in thousands of Canadian dollars | Notes | Years ended December 31 2019 | 2018 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Net income | | **67,381** | 89,120 |
| Amortization/depreciation of intangible assets, right-of-use assets and property, plant and equipment | 7, 8,10 | **55,593** | 43,809 |
| Loss on disposal of property, plant and equipment | 7 | **32** | 313 |
| Gain on disposal of joint venture investment | 11 | **(881)** | – |
| Decrease in defined benefit plans | 23 | **(68)** | (597) |
| Accretion of financial liabilities | 27 | **2,478** | 1,006 |
| Deferred taxes | 19 | **7,041** | 8,164 |
| Income on investments in joint ventures | 11 | **(490)** | (669) |
| Change in non-cash working capital | 30 | **(26,881)** | (41,149) |
| **Net cash provided by operating activities** | | **104,205** | 99,997 |
| **Cash flow from investing activities** | | | |
| Business combination, net of cash acquired | 11 | **(5,519)** | – |
| Purchase of property, plant and equipment | 7 | **(51,820)** | (48,346) |
| Proceeds from disposal of property, plant and equipment | 7 | **388** | 411 |
| Change in restricted cash | | **–** | 3,329 |
| Increase in intangible and other assets | | **(5,301)** | (2,728) |
| **Net cash used in investing activities** | | **(62,252)** | (47,334) |
| **Cash flow from financing activities** | | | |
| Decrease in bank indebtedness | 12, 18 | **–** | (264) |
| (Decrease) increase in debt due within one year | 18 | **(1,720)** | 3,892 |
| Decrease in long-term debt | 14,18 | **(4,124)** | (15,165) |
| Lease liability payments | 15, 18 | **(3,972)** | – |
| Decrease in long-term liabilities and provisions | 17, 18 | **(44)** | (945) |
| (Decrease) increase in borrowings, net | 16, 18 | **(803)** | 1,302 |
| Common share dividend | 20 | **(23,575)** | (20,664) |
| **Net cash used in financing activities** | | **(34,238)** | (31,844) |
| **Increase in cash during the year** | | **7,715** | 20,819 |
| Cash at beginning of the year | | **63,316** | 40,394 |
| Effect of exchange rate differences | | **(1,394)** | 2,103 |
| **Cash at end of the year** | | **69,637** | 63,316 |

See accompanying notes to the consolidated financial statements

## 1. SIGNIFICANT ACCOUNTING POLICIES

### Description of Business

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

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

### Statement of Compliance

These consolidated financial statements are prepared under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were authorized for issuance by the Board of Directors of the Corporation on March 6, 2020.

### Basis of Presentation

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair value. These consolidated financial statements have been prepared using IFRS principles applicable to a going concern, which contemplate the realization of assets and settlement of liabilities in the normal course of business as they come due. All amounts are presented in Canadian dollars, unless otherwise indicated.

The Corporation's significant accounting policies are set out below. These accounting policies have been applied consistently to all periods presented in these consolidated financial statements and by all entities.

### Basis of Consolidation

The consolidated financial statements of the Corporation include the assets and liabilities, and the results of operations and cash flows of the Corporation and its subsidiaries and the Corporation's interest in its joint ventures. The financial statements of entities consolidated have a reporting date of December 31. Entities over which the Corporation has control are accounted for as subsidiaries. Control is achieved when the Corporation is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Where the Corporation has the ability to exercise joint control, the entities are accounted for as joint ventures and are incorporated into the consolidated financial statements using the equity method of accounting. Interests acquired in entities are consolidated from the date the Corporation acquires control and interests sold are de-consolidated from the date control ceases. Wholly owned operating subsidiaries of the Corporation are:

- Magellan Aerospace Limited
- Magellan Aerospace (UK) Limited
- Magellan Aerospace USA, Inc.

The effects of intragroup transactions are eliminated. Trade receivables and accounts payable as well as expenses and income between the consolidated entities are netted. Internal sales are transacted on the basis of market prices and intragroup profits and losses are eliminated.

**Determination of Fair Value**

Fair value is determined based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is measured using the assumptions that market participants would use when pricing an asset or liability. Fair value is determined by using quoted prices in active markets for identical or similar assets or liabilities. When quoted prices in active markets are not available, fair value is determined using valuation techniques that maximize the use of observable inputs.

When observable valuation inputs are not available, significant judgment is required to determine fair value by assessing the valuation techniques and valuation inputs. The use of alternative valuation techniques or valuation inputs may result in a different fair value.

**Foreign Currency Translation**

The consolidated financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

Foreign currency denominated monetary assets and liabilities are translated at the rates of exchange at the statement of financial position date. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at that date, whereas non-monetary items measured at historic cost, are translated using the exchange rate prevailing on the transaction date. Translation gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in income.

Assets and liabilities of foreign operations that have a functional currency different from the presentation currency are translated using the closing exchange rate prevailing at the reporting date and revenues and expenses at average exchange rates during the period. Translation gains and losses on currency translation are recognized as a separate component of equity in other comprehensive income and do not have any impact on the net income (loss) for the year.

**Segment Reporting**

Management has determined the operating segments based on information regularly reviewed for the purposes of decision making, allocating resources and assessing performance by the Corporation's chief operating decision makers. The Corporation evaluates the financial performance of its operating segments primarily based on net income before interest and income taxes.

**Revenue Recognition**

Revenue is primarily comprised of sales of goods and rendering of services and recognized when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the Corporation expects to be entitled in exchange for those goods or services. The Corporation's revenue recognition methodology is determined on a contract-by-contract basis.

*Performance Obligation*

A performance obligation is a contractual promise with a customer to transfer a distinct good or service and is the unit of account for revenue recognition.

The Corporation accounts for a contract with customers when it has approval and commitment from both parties, each party's rights have been identified, payment terms are defined, the contract has commercial substance and collection is probable. The Corporation is the principal in its revenue arrangements because it typically controls the goods or services before transferring them to the customer.

A contract transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The transaction price includes, among other things and when applicable, an estimate of variable consideration to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur at the time when the uncertainty associated with the variable consideration is resolved. Variable consideration is usually derived from sales incentives, in the form of discounts or volume rebates. The estimation of variable consideration is largely based on the assessment of the Corporation's historical, current and forecasted information that is reasonably available.

For contracts with multiple performance obligations, the contract transaction price, including variable consideration when applicable, is allocated based on the estimated relative stand-alone price of the promised goods or services underlying each performance obligation. The Corporation generally uses the expected cost plus a margin approach to estimate the stand-alone selling price of each performance obligation when a stand-alone selling price is not directly observable.

The Corporation's performance obligations are satisfied over time or at a point in time.

Revenues from sale of goods are recognized over time when the Corporation's performance does not create an asset with alternative use and the Corporation has an enforceable right to payment for performance completed to date. The Corporation recognizes revenue over time using the cost-to-cost input method, which recognizes revenue as performance of the contract progresses. Contracts that do not meet the criteria for over time recognition are recognized at a point in time when the goods are dispatched or made available to the customer. The sale of consignment products are recognized on notification that the product has been used.

Revenues from rendering services are recognized over time as customers simultaneously receive and consume the benefits provided by the Corporation. The Corporation recognizes revenues for repair and overhaul services using the cost-to-cost input method as the basis for measuring the progress on the contract.

Other revenues are recognized at a point in time or over time as performance obligations are satisfied, depending on the nature of the contract.

The Corporation typically provides warranties for general repairs of defects that existed at the time of sale, as required by law. These assurance-type warranties are not separate performance obligations and are accounted for under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.*

*Contract Balances*

Contract assets include unbilled amounts when over time method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer, and right to payment is not just subject to the passage of time. Amounts may not exceed their net realizable value. Contract assets are generally classified as current.

Contract liabilities consist of advance payments and deferred revenue. Contract assets and liabilities are reported in a net position on a contract by-contract basis at the end of each reporting period. Advance payments are classified as current or non-current based on the timing of when revenue is expected to be recognized. The current portion of contract liabilities is included in accounts payable and accrued liabilities and provisions and the non-current portion is included in other long-term liabilities and provisions in the consolidated statement of financial position.

**Cost of Revenues**

Cost of revenues consists of production-related manufacturing costs of products sold, development services paid, and the cost of products purchased for resale. In addition to the direct material cost and production costs, it also comprises systematically allocated overheads, including depreciation of production-related property, plant and equipment, and intangible assets, write-downs on inventories and an appropriate portion of production-related administrative overheads.

**Government Grants**

Government grants are recognized at their fair value in the period when there is reasonable assurance that the conditions attached to the grant will be met and that the grant will be received. Grants are recognized as income over the periods necessary to match them with the related costs that they are intended to compensate. Grants relating to expenditure on property, plant and equipment and on intangible assets are deducted from the carrying amount of the asset. The grant is therefore recognized as income over the life of the depreciable asset by way of a reduced depreciation charge. Repayable grants are treated as sources of financing and are recognized in borrowings subject to specific conditions in the consolidated statements of financial position. Repayments made are recorded as a reduction of the liability.

**Government Assistance**

Government assistance is comprised of investment tax credits and scientific research and experimental development tax credits. These credits are recognized when there is reasonable assurance of their recovery using the cost reduction method. Investment tax credits are subject to the customary approvals by the pertinent tax authorities. Adjustments required, if any, are reflected in the year when such assessments are received.

**Employee Benefits**

*Defined benefit plans*

The Corporation's obligation in respect of defined benefit plans is determined periodically by independent actuaries using the projected unit credit method in accordance with IAS 19, *Employee Benefits*. Actuarial gains and losses are recognized in full in the period in which they occur, and are recognized in other comprehensive income and immediately transferred to retained earnings. Past service cost is recognized immediately to the extent the benefits are already vested, or otherwise is recognized on a straight-line basis over the average period until the benefits become vested. Curtailments due to the significant reduction of the expected years of future services of current employees or the elimination of the accrual of defined benefits for some or all of the future services for a significant number of employees are recognized immediately as a gain or loss in the consolidated statements of income.

The defined benefit surplus or deficit represents the fair value of the plan assets less the present value of the defined benefit obligations. A surplus is recognized in the statement of financial position to the extent that the Corporation has an unconditional right to the surplus, either through a refund or reduction in future contributions. A deficit is recognized in full.

*Defined contribution plans*

Obligations for contributions to defined contribution plans are recognized as an expense in the consolidated statements of income as incurred.

*Share-based compensation*

The fair value of awards made under share-based compensation plans is measured at the grant date and allocated over the vesting period, based on the best available estimate of the number of share options expected to vest, in the consolidated statements of income with a corresponding increase in equity. The fair value is measured using an appropriate valuation model taking into account the terms and conditions of the individual plans. The amount recognized as an expense is adjusted to reflect the actual awards vesting except where any change in the awards vesting relates only to market-based criteria not being achieved.

The cost of cash-settled transactions is measured initially at fair value at the grant date using a binomial model, taking into account the terms and conditions upon which the share awards were granted. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is remeasured to fair value at each reporting date up to and including the settlement date, with changes in fair value recognized in the consolidated statements of income.

**Taxation**

The tax charge for the period consists of both current and deferred income tax. Taxation is recognized as a charge or credit in the consolidated statements of income except to the extent that it relates to items recognized directly to equity in which case the related tax is also recognized in equity.

Current income tax is the expected tax payable on the taxable income for the year and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are established using the balance sheet liability method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible timing differences can be utilized.

Deferred tax liabilities are not recognized for temporary differences arising on investment in subsidiaries where the Corporation is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax is calculated at the enacted or substantively enacted tax rates that are expected to apply in the period when the liability is settled or the asset is realized.

Deferred income tax assets and liabilities are only offset where they arise within the same entity and tax jurisdiction.

Deferred income tax assets and liabilities are presented as non-current.

**Net Income per Share**

Net income per share is calculated based on the profit for the financial year and the weighted average number of common shares outstanding during the year. Diluted net income per share is calculated using the profit for the financial year adjusted for the effect of any dilutive instruments and the weighted average diluted number of shares (ignoring any potential common shares issued which would be anti-dilutive) during the year.

**Inventories**

Inventory is stated at the lower of average cost and net realizable value.

The unit cost method is the prescribed cost method under which the actual production costs are charged to each unit produced and recognized to income as the unit is sold.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage or declining selling prices. When circumstances that previously caused inventories to be written down below cost no longer exist, the amount of the write-down previously recorded is reversed.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost, less accumulated depreciation and any impairment in value. Cost includes the purchase price (after deducting trade discounts and rebates), any directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, and the estimate of the present value of the costs of dismantling and removing the item and restoring the site. Subsequent costs are included in the assets carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Corporation and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The cost of the day-to-day servicing of property, plant and equipment are recognized in the consolidated statements of income as incurred.

Depreciation is calculated using the straight-line method to allocate the cost of property, plant and equipment to their residual values over their estimated useful lives.

Scheduled depreciation is based on the following useful lives:

| Assets | in years |
|---|---|
| Buildings | 40 |
| Machinery and equipment | 10-20 |
| Tooling | 5-7 |
| Leasehold improvements | term of lease |

The residual values, useful lives and depreciation methods pertaining to property, plant and equipment are regularly assessed for relevance, at least at every statement of financial position date, and adjustments are made when necessary. An asset's carrying value is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. These impairment losses are recognized in the consolidated statements of income. Following the recognition of an impairment loss, the depreciation charge applicable to the asset is adjusted prospectively in order to systematically allocate the revised carrying amount, net of any residual value, over the remaining useful life.

**Investment Properties**

Investment property is property held to earn rental income and/or for capital appreciation rather than for the purpose of the Corporation's operating activities. Investment property assets are carried at cost less accumulated depreciation and any recognized impairment in value. The depreciation policies for investment property are consistent with those described for property, plant and equipment.

**Intangible Assets**

Externally acquired and internally generated intangible assets are recognized only if they meet strict criteria, relating in particular to technical feasibility, probability that a future economic benefit associated with the asset will flow to the entity and the cost of the asset can be measured reliably. Expenditure on research activities is recognized as an expense in the period in which it is incurred.

Intangible assets with a finite useful life are stated at cost and amortized on a unit of production basis. Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in the consolidated statements of income when the asset is de-recognized.

**Leases**
At inception of a contract, the Corporation assesses whether the contract is, or contains, a lease. A contract is a lease if the contract conveys the right to control the use of an identified asset. Leases with a term of twelve months or less are not recorded by the corporation on the consolidated statements of financial position.

*Lessee accounting*
The Corporation records a right-of-use asset and a lease liability at the lease commencement date based on the present value of the future lease payments over the lease term.

The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Corporation's incremental borrowing rate. After the commencement date, the lease liability shall be remeasured to reflect changes to the lease payments. Variable lease payments that depend on an index or a rate are included in the measurement of the lease liability when information is available. The right-of-use asset is typically depreciated on a straight-line basis over the lease term, unless the Corporation expects to obtain ownership of the leased asset at the end of the lease.

Certain of the Corporation's leases contain extension or renewal options. At lease commencement, the Corporation assesses whether it will be reasonably certain to exercise any of the extension options based on its expected economic return from the lease. The Corporation periodically reassesses whether it will be reasonably certain to exercise the options and accounts for any changes at the date of reassessment.

*Lessor accounting*
When the Corporation acts as a lessor, it assesses at lease inception whether the lease transfers to the lessee substantially all of the risks and rewards incidental to ownership of the underlying asset. If it does, the lease is a finance lease, if not, it is an operating lease.

**Business Combinations and Goodwill**
The Corporation accounts for business combinations using the acquisition method, under which the acquirer measures the cost of the business combination as the total of the fair values, at the date of exchange, of the assets transferred, liabilities incurred and equity instruments issued by the acquirer in exchange for control of the acquiree. Goodwill is measured as the fair value of the consideration transferred, including the recognized amount of any non-controlling interest in the acquiree, less the net recognized amount (generally the fair value) of the identifiable assets and liabilities assumed, measured as at the acquisition date. The primary items that generate goodwill include the value of the synergies between the acquired company and the Corporation and the value of the acquired assembled workforce, neither of which qualifies for recognition as an intangible asset. Goodwill is assigned to one or more cash-generating units ("CGU") on the date of acquisition. Acquisition-related expenses and post-acquisition restructuring costs are recognized separately from the business combination and are expensed as incurred.

**Impairment of Non-Financial Assets**
The carrying amounts of the Corporation's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset or its CGUs recoverable amount is estimated. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. Non-financial assets that have an indefinite

useful life such as goodwill and certain intangible assets, are not subject to amortization and are therefore tested annually for impairment or more frequently if events or changes in circumstances indicate that the asset might be impaired.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purposes of goodwill impairment testing, goodwill acquired in a business combination is allocated to the CGU, or the group of CGUs, that is expected to benefit from the synergies of the combination. Each CGU or group of CGUs to which goodwill is allocated must represent the lowest level at which the goodwill is monitored for internal management purposes and must not be, before allocating the goodwill, larger than an operating segment.

The Corporation's corporate assets do not generate separate cash inflows and are utilized by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognized in net income. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGUs, and then to reduce the carrying amounts of the other assets in the CGU or group of CGUs on a pro rata basis of the carrying amount of each asset of the CGU that is subject to the impairment test.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

**Financial Instruments**

The Corporation recognizes financial assets and financial liabilities ("financial instruments") on the date the Corporation becomes a party to the contractual provisions of the instruments. A financial asset is derecognized either when the Corporation has transferred substantially all the risks and rewards of ownership of the financial asset or when cash flows expire. A financial liability is derecognized when the obligation specified in the contract is discharged, canceled or expired.

The Corporation's financial instruments include cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, lease liabilities, bank indebtedness, long-term debt, borrowing subject to specific conditions, and other non-derivative and derivative financial assets and liabilities.

The classifications of financial instruments are typically determined at the time of initial recognition and are recognized at fair value, plus attributable transaction costs where applicable. Subsequent to initial recognition, financial instruments are classified and measured as described below.

*Financial assets at fair value through profit or loss*

Cash and cash equivalents, restricted cash and derivatives instruments are classified as financial assets at fair value through profit or loss and are measured at fair value. Cash equivalents are short-term investments with initial maturities of three months or less. The Corporation manages its foreign currency and interest rate exposures through the use of derivative financial instruments. The Corporation's policy is not to utilize derivative instruments for trading or speculative purposes. The Corporation's derivative contracts are not designated as hedges and as a result are presented on the consolidated statement of financial position as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. The unrealized gains or losses related to changes in fair value are reported in other expense (income) on the consolidated statements of income. Transaction costs incurred to acquire financial instruments are included in the underlying balance.

*Financial instruments carried at amortized cost*

Financial instruments in this category include trade and other receivables, accounts payable and accrued liabilities, bank indebtedness, borrowing subject to specific conditions, lease liabilities and long-term debt. Financial instruments are recorded initially at fair value and, in the case of financial assets and liabilities carried at amortized cost, adjusted for directly attributable transaction costs. Trade and other receivables include originated non-derivative financial assets with fixed or determined payments that are not quoted in an active market and are subsequently measured at amortized cost and is computed using the effective interest method less any allowance for impairment. Accounts payables and accrued liabilities, bank indebtedness, borrowing subject to specific conditions, finance lease liabilities and long-term debt are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees. The effective interest rate accretion is included as finance costs in the consolidated statements of income.

*Impairment*

The expected credit loss impairment model applies to financial assets carried at amortized costs. The model uses a dual measurement approach, under which the loss allowance is measured as either 12 month expected credit losses or at the lifetime expected credit losses. The Corporation applies the simplified approach and records lifetime expected losses on accounts receivables and contract assets based on historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. If in a subsequent year, the amount of the estimated impairment loss increases or decreases due to an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or decreased by adjusting the carrying value of the financial assets. If a past write-off is later recovered, the recovery is recognized in the consolidated statements of income.

**Provisions**

A provision is recognized when there is a present legal or constructive obligation, as a result of a past event, which is more likely than not to result in an outflow of economic benefits and where a reliable estimate of the amount of the obligation can be made. If the effect is material, the provision is determined by discounting the expected future cash flows at a pre-tax risk-free rate and, where appropriate, the risks specific to the liability. A provision for onerous contracts is recognized when the expected benefits to be derived from the contracts are less than the related unavoidable costs of meeting its obligations under the contract. Such provisions are recorded as write-downs of work-in-progress for that portion of the work which has already been completed, and as liability provisions for the remainder.

**Share Capital**

Common shares are classified as equity. Transaction costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any income taxes.

**Estimates, Assumptions and Judgements**

The preparation of consolidated financial statements requires management to make critical judgements, estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses recorded during the reporting period. The critical estimates and judgements utilized in preparing the Corporation's consolidated financial statements affect the assessment of net recoverable amounts, net realizable values and fair values, depreciation and amortization rates and useful lives, value of intangible assets, ability to utilize tax losses and other tax measurements, determination of functional currency, determination of the degree of control that exists in determining the corresponding accounting basis, and the selection of accounting policies. Any changes in estimates and assumptions could have a material impact on the Corporation's future income and/or the amounts reported in its statement of financial position. The Corporation reviews its estimates and assumptions on an ongoing basis and uses the most current information available and exercises careful judgement in making these estimates and assumptions.

The main assumptions and estimates that were used in preparing the Corporation's consolidated financial statements relate to:

*Financial instruments*
The valuation of the Corporation's derivative instruments and certain other financial instruments requires estimation of the fair value of each instrument at the reporting date. Details of the basis on which fair value is estimated are provided in note 22 to the consolidated financial statements.

*Impairments*
The recoverable amount of intangible assets and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each CGU or group of CGUs.

In order to estimate the fair value of indefinite-lived intangible assets and goodwill resulting from business combinations, the Corporation typically estimates future revenue, considers market factors and estimates future cash flows. Based on these key assumptions, judgments and estimates, the Corporation determines whether to record an impairment charge to reduce the value of the asset carried on the consolidated statements of financial position to its estimated fair value. Assumptions, judgments and estimates about future values are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in the Corporation's business strategy or internal forecasts. Although the Corporation believes the assumptions, judgments and estimates made in the past have been reasonable and appropriate, different assumptions, judgments and estimates could materially affect the Corporation's reported financial results.

*Deferred taxes*
Income taxes are determined based on estimates of the Corporation's current income taxes and estimates of deferred income taxes resulting from temporary differences. Deferred tax assets are assessed to determine the likelihood that they will be realized from future taxable income before they expire.

*Government assistance*
Investment tax credits and scientific research and experimental development tax credits are determined based on estimates of the Corporation's current year expenditures on qualifying programs. The investment tax credits are assessed to determine the likelihood that they will be applied against federal income taxes.

*Capitalization of development costs*
When capitalizing development costs the Corporation must assess the technical and commercial feasibility of the projects and estimate the useful lives of resulting products. Determining whether future economic benefits will flow from the assets and therefore the estimates and assumptions associated with these calculations are instrumental in (i) deciding whether project costs can be capitalized, and (ii) accurately calculating the useful life of the projects for the Corporation.

*Leases*
The Corporation determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend or terminate the lease. The lease term is estimated by considering the facts and circumstances that can create an economic incentive to exercise an extension option, or not exercise the termination option. Both qualitative and quantitative assumptions are considered when deriving the value of the economic incentive.

The Corporation makes judgments in determining whether a contract contains an identified asset. The identified asset should be physically distinct or represent substantially all of the capacity of the asset, and should provide the Corporation with the right to substantially all of the economic benefits from the use of the asset.

Judgments are made by the Corporation in determining the incremental borrowing rate used to measure the lease liability for each lease contract, including an estimate of the asset-specific security impact. The incremental borrowing rate should reflect the interest rate that the Corporation would have to pay to borrow at a similar term and with a similar security.

*Income (loss) on completion of contracts*
To estimate income (loss) on completion, the Corporation takes into account factors inherent to the contract by using historical and/or forecast data.

*Repayable government grants*
The forecast repayment of grants received from government authorities is based on future sales. As the forecast repayments are closely related to forecasts of future sales set out in business plans prepared by the operating divisions, the estimates and assumptions underlying these business plans are instrumental in determining the timing of these repayments.

*Employee benefits*
The Corporation considers a number of factors in developing the pension assumptions, including an evaluation of relevant discount rates, plan asset allocations, mortality, expected changes in wages and retirement benefits, analysis of current market conditions, economic benefits available and input from actuaries and other consultants. Costs of the programs are based on actuarially determined amounts and are accrued over the period from the date of hire to the full eligibility date of employees who are expected to qualify for these benefits.

## 2. NEW AND AMENDED INTERNATIONAL FINANCIAL REPORATING STANDARDS

### New and Amended International Financial Reporting Standards Adopted in 2019
The Corporation has adopted the following new and amended standards in the current year.

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

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

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

For leases that were classified as operating leases under IAS 17, lease liabilities at transition have been measured at the present value of remaining lease payments, discounted at the incremental borrowing rate as at January 1, 2019. Right-of-use assets at transition have been measured at an amount equal to the corresponding lease liabilities, adjusted for any prepaid or accrued rent relating to that lease. The weighted average discount rate applied to the total lease liabilities recognized on transition was 3.82%.

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

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

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

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

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

**Uncertainty over Income Tax Treatments**

In June 2017, IASB issued IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments* ("IFRIC 23"), which clarifies application of recognition and measurement requirements in IAS 12, *Income Taxes* when there is uncertainty over income tax treatments. IFRIC 23 is effective for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted. The adoption of IFRIC 23 has no impact on the Corporation's consolidated financial statements.

**Amendments to IAS 19 Plan Amendment, Curtailment or Settlement**

In February 2018, the IASB issued amendments to IAS 19, *Employee Benefits* ("IAS 19") which address the accounting for plan amendments, curtailments or settlements during the reporting period. The amendments to IAS 19 require an entity to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and to recognize in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognized because of the impact of the asset ceiling. The amendments apply to plan amendments, curtailments or settlements that occur on or after January 1, 2019, with earlier application permitted. The amendments will have an impact on the Corporation's consolidated financial statements when there are plan amendments, curtailments or settlements after the effective date.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

**Annual Improvements to IFRS Standards 2015 – 2017**

In December 2017, IASB issued the following amendments from the 2015-2017 annual improvement cycle.

*IFRS 3 Business Combination*

The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019. Earlier application is permitted. These amendments will apply on business combinations of the Corporation after January 1, 2019.

*IAS 12 Income Taxes*

The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events. An entity applies those amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted. When an entity first applies those amendments, it applies them to the income tax consequences of dividends recognized on or after the beginning of the earliest comparative period. The Corporation does not expect these amendments will have an impact on the Corporation's consolidated financial statements.

## 3. CASH AND CASH EQUIVALENTS

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Cash on hand | **34,108** | 3,795 |
| Short term deposits | **35,529** | 59,521 |
| | **69,637** | 63,316 |

Bank balances and short-term deposits comprise of cash held by the Corporation on a short-term basis with original maturity of one month or less. The carrying amount of these assets approximates their fair value.

## 4. TRADE AND OTHER RECEIVABLES

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Trade receivables | **148,451** | 167,267 |
| Less allowance for doubtful accounts | **369** | 388 |
| Net trade receivables | **148,082** | 166,879 |
| Other receivables | **29,719** | 21,018 |
| | **177,801** | 187,897 |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The following table presents the aging of gross trade receivables:

| | Current | Less than 90 days | 91-181 days | 182-365 days | More than 365 days | Total |
|---|---|---|---|---|---|---|
| December 31, 2018 | 155,753 | 10,198 | 654 | 645 | 17 | 167,267 |
| **December 31, 2019** | **133,907** | **11,055** | **1,304** | **21** | **2,164** | **148,451** |

## 5. CONTRACT BALANCES

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Contract assets | **77,967** | 66,436 |
| Contract liabilities | **(10,605)** | (9,029) |
| Net contract balances | **67,362** | 57,407 |

Contract assets relate to the Corporation's right to consideration for performance completed under the contract and not invoiced. The contract assets are transferred to trade and other receivables when the right to consideration becomes unconditional. Contract liabilities relate to payments received in advance of performance under the contract. Contract liabilities are recognized as revenue when the Corporation performs under the contract. Contract liabilities are included in accounts payable, accrued liabilities and provision on the consolidated statement of financial position.

Revenue recognized in the period from:

| | **2019** | 2018 |
|---|---|---|
| Amounts included in contract liabilities at the beginning of the year | **9,029** | 6,602 |

## 6. INVENTORIES

| | Raw materials | Work in progress | Finished goods | Total |
|---|---|---|---|---|
| At December 31, 2018 | 68,006 | 84,871 | 22,205 | 175,082 |
| **At December 31, 2019** | **74,674** | **92,354** | **29,795** | **196,823** |

The cost of inventories recognized as expense and included in cost of sales for the year ended December 31, 2019 amounted to $842,184 [2018 – $792,040].

During the year ended December 31, 2019, the Corporation recorded an impairment expense related to the write-down of inventory in the amount of $2,083 [2018 – $1,078]. The Corporation also recorded reversals of previous write-downs of inventory in the amount of $1,626 [2018 – $1,807] due to the sale of inventory previously provided for. The carrying amount of inventory recorded at net realizable value was $22,277 as at December 31, 2019 [2018 – $22,276], with the remaining inventory recorded at cost.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

## 7. PROPERTY, PLANT, AND EQUIPMENT

| | Land | Buildings | Machinery & Equipment | Tooling | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At December 31, 2017 | 17,927 | 126,733 | 600,653 | 48,789 | 794,102 |
| Additions | 389 | 7,953 | 37,327 | 1,193 | 46,862 |
| Disposals and other | – | (38) | (5,856) | (525) | (6,419) |
| Foreign currency translation | 610 | 4,041 | 26,325 | 3,627 | 34,603 |
| At December 31, 2018 | 18,926 | 138,689 | 658,449 | 53,084 | 869,148 |
| Additions | 42 | 6,611 | 40,861 | 4,241 | 51,755 |
| Acquisitions | 2,921 | 1,460 | 2,280 | – | 6,661 |
| Disposals and other | – | – | (4,909) | – | (4,909) |
| Foreign currency translation | (456) | (2,863) | (17,040) | (2,202) | (22,561) |
| **At December 31, 2019** | **21,433** | **143,897** | **679,641** | **55,123** | **900,094** |
| **Accumulated depreciation and impairment** | | | | | |
| At December 31, 2017 | – | (51,960) | (297,198) | (43,089) | (392,247) |
| Depreciation | – | (3,757) | (28,681) | (2,175) | (34,613) |
| Disposal and other | – | 2 | 4,769 | 462 | 5,233 |
| Foreign currency translation | – | (1,576) | (13,841) | (3,226) | (18,643) |
| At December 31, 2018 | – | (57,291) | (334,951) | (48,028) | (440,270) |
| Depreciation | – | (4,384) | (30,878) | (1,880) | (37,142) |
| Disposal and other | – | – | 4,489 | – | 4,489 |
| Foreign currency translation | – | 1,032 | 8,911 | 1,988 | 11,931 |
| **At December 31, 2019** | **–** | **(60,643)** | **(352,429)** | **(47,920)** | **(460,992)** |
| **Net book value** | | | | | |
| At December 31, 2018 | 18,926 | 81,398 | 323,498 | 5,056 | 428,878 |
| **At December 31, 2019** | **21,433** | **83,254** | **327,212** | **7,203** | **439,102** |

As at December 31, 2018 and 2019, the Corporation did not have any assets under finance lease.

Included in the above are assets under construction in the amount of $14,168 [December 31, 2018 – $21,527], which as at December 31, 2019 are not amortized.

## 8. RIGHT-OF-USE ASSETS

| | Buildings | Machinery, equipment and others | Total |
|---|---|---|---|
| At January 1, 2019 | 23,549 | 955 | 24,504 |
| Addition | 24,605 | 562 | 25,167 |
| Depreciation, disposal and other | (3,775) | (401) | (4,176) |
| Foreign currency translation | (773) | (30) | (803) |
| **At December 31, 2019** | **43,606** | **1,086** | **44,692** |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

## 9. INVESTMENT PROPERTIES

| | Cost | Accumulated depreciation, disposal and impairment | Net book value |
|---|---|---|---|
| At December 31, 2018 | 9,353 | (7,048) | 2,305 |
| **At December 31, 2019** | **9,313** | **(7,133)** | **2,180** |

The Corporation's investment properties consist of land and building. Depreciation expense recognized in relation to the buildings in 2019 was $96 [2018 - $158]. The Corporation recorded rental income from investment properties of $467 in 2019 [2018 - $600].

The fair value of the Corporation's investment properties was $19,363 at December 31, 2019. The fair value was determined through the use of the market comparable approach and discounted cash flows approach which are categorized as a Level 3 in the fair value hierarchy. In 2019, the Corporation obtained opinions from external valuators, with experience in the real estate market, on $18,500 of the total fair values of the Corporation's investment properties.

## 10. INTANGIBLE ASSETS AND GOODWILL

| | Technology rights | Development costs | Other intangibles | Total intangible assets | Goodwill | Total intangible assets and goodwill |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At December 31, 2017 | 45,106 | 121,136 | 26,839 | 193,081 | 33,441 | 226,522 |
| Additions | – | 3,839 | 4,835 | 8,674 | – | 8,674 |
| Foreign currency translation | 164 | 3,791 | 1,117 | 5,072 | 1,663 | 6,735 |
| At December 31, 2018 | 45,270 | 128,766 | 32,791 | 206,827 | 35,104 | 241,931 |
| Additions | – | 4,563 | 12,997 | 17,560 | – | 17,560 |
| Foreign currency translation | (98) | (2,270) | (784) | (3,152) | (967) | (4,119) |
| **At December 31, 2019** | **45,172** | **131,059** | **45,004** | **221,235** | **34,137** | **255,372** |
| **Depreciation and impairement** | | | | | | |
| At December 31, 2017 | (31,472) | (93,034) | (7,080) | (131,586) | – | (131,586) |
| Depreciation | (1,779) | (4,178) | (2,847) | (8,804) | – | (8,804) |
| Foreign currency translation | (111) | (3,291) | (290) | (3,692) | – | (3,692) |
| At December 31, 2018 | (33,362) | (100,503) | (10,217) | (144,082) | – | (144,082) |
| Depreciation | (1,796) | (8,903) | (3,251) | (13,950) | – | (13,950) |
| Foreign currency translation | 69 | 1,919 | 182 | 2,170 | – | 2,170 |
| **At December 31, 2019** | **(35,089)** | **(107,487)** | **(13,286)** | **(155,852)** | **–** | **(155,862)** |
| **Net book value** | | | | | | |
| At December 31, 2018 | 11,908 | 28,263 | 22,574 | 62,745 | 35,104 | 97,849 |
| **At December 31, 2019** | **10,083** | **23,572** | **31,718** | **65,373** | **34,137** | **99,510** |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

Technology rights relate to an agreement which permits the Corporation to manufacture aerospace engine components and share in the revenue generated by the final sale of the engine.

The Corporation has certain programs that meet the criteria for deferral and amortization of development costs. Development costs are capitalized for clearly defined, technically feasible technologies which management intends to produce and promote to an identified future market, and for which resources exist or are expected to be available to complete the project. The Corporation records amortization in arriving at the carrying value of deferred development costs once the development activities have been completed and sales of the related product have commenced. The Corporation estimates the intangible assets to be amortized over a period up to 20 years based on units of production.

Other intangibles relate to application software, customer lists, brands and technical processes. Application software will be amortized over a 10 year period, customer lists will be amortized over a 5 year period and technical processes will be amortized over a 15 year period. Brands of $8,975 (£5,226) with indefinite useful lives assets are not subject to amortization.

As described in note 1, the carrying values of goodwill and intangible assets with indefinite lives are tested for impairment annually. The Corporation's impairment test for goodwill and intangible assets with indefinite useful lives was based on the recoverable amount determined on its value in use. The key assumptions used to determine the recoverable amount are discussed below. The Corporation completed the annual impairment test on October 1, 2019 and determined there was no impairment. The results of the annual impairment test indicate that the fair values of the reporting units are in excess of their carrying values.

In the assessment of impairment, management used industry guidance, historical data and past experience as the key assumptions in the determination of the recoverable amount of the two CGUs. The value in use was determined based on the present value of the estimated free cash flows for the two CGUs. The cash flow projections, covering a five year period plus a terminal year, were based on financial projections approved by management using assumptions that reflect the Corporation's most likely planned course of action, given management's judgment of the most probable set of economic conditions. A discount rate of 11.0% and 9.0% per annum was used for the two CGUs, respectively, based on management's best estimate of the Corporation's weighted average cost of capital adjusted for the risks facing the CGU. Annual growth rate of 2% and 3% was used in the terminal year given the businesses' anticipated growth. The recoverable amount was determined to be higher than the carrying value including the goodwill. If the discount rate for the CGUs is increased by 1%, the recoverable amount for both CGUs would be less than the carrying value.

## 11. INVESTMENTS IN JOINT VENTURES

The Corporation has interests in a number of individually non-material joint ventures. The Corporation's joint ventures are private entities that are not listed on any public exchange. All operations are continuing. To support the activities of certain joint ventures, the Corporation and the other investors in the joint ventures have agreed to make additional contributions, in proportion to their interests, to make up any losses, if required. In addition, profits of the joint ventures are not distributed until the parties to the arrangement provide consent for distribution. The Corporation has no share of any contingent liabilities or capital commitments in its joint ventures as at December 31, 2019 and December 31, 2018.

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Balance, beginning of the year | **7,484** | 6,815 |
| Disposal of joint venture investment | **(5,498)** | – |
| Share of total comprehensive income | **490** | 669 |
| Balance, end of the year | **2,476** | 7,484 |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

In line with the Corporation's low cost sourcing strategy, an additional 26% of the issued and outstanding shares of the capital stock of Triveni Aeronautics Private Limited ("Triveni") was acquired in the first quarter of 2019 for $3,780 to obtain a 75% controlling interest.

Prior to the effective date February 28, 2019, the Corporation accounted for it's previously held 49% interest in Triveni as a joint venture using the equity method with a carrying value of $5,498. As at February 28, 2019, the Corporation remeasured its previously held equity interest at fair value and recognized the resulting gain of $881 in Other in the consolidated statement of income.

At February 28, 2019, the Corporation recognized $4,765 current assets, $5,610 non-current assets, $6,142 intangible assets, $596 current liabilities, $2,385 non-current liabilities, and $3,377 non-controlling interest based on the fair value of the identifiable assets and liabilities. The net income recorded in the year ended December 31, 2019 includes an immaterial amount attributable to the non-controlling interest.

## 12. BANK INDEBTEDNESS

On September 13, 2018, the Corporation amended its credit agreement with its existing lenders. The Corporation has a multi-currency operating credit facility with a syndicate of banks, with a Canadian dollar limit of $75,000. Extensions of the facility are subject to mutual consent of the syndicate of lenders and the Corporation. The credit agreement also includes a $75,000 uncommitted accordion provision which will provide the Corporation with the option to increase the size of the operating credit facility. As at December 31, 2019, the Corporation was debt-free under its credit facility. Bank indebtedness bears interest at the bankers' acceptance or LIBOR rates plus 1.00%. At December 31, 2019, the Corporation had letters of credit outstanding totalling $5,770 such that $69,230 was unused and available. A fixed and floating charge debenture on accounts receivable, inventories and property, plant and equipment is pledged as collateral for the operating credit facility. On October 28, 2019 the Corporation extended the credit agreement to September 13, 2021.

## 13. ACCOUNTS PAYABLE, ACCRUED LIABILITIES AND PROVISIONS

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Accounts payables | **85,581** | 86,754 |
| Accrued liabilities | **53,159** | 55,981 |
| Contract liabilities [note 5] | **10,605** | 9,029 |
| Provisions [note 17] | **2,562** | 2,643 |
| | **151,907** | 154,407 |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

## 14. LONG-TERM DEBT

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Property mortage [a] | **447** | 769 |
| Other loans [b] | **8,904** | 10,811 |
| | **9,351** | 11,580 |
| Less current portion | **2,475** | 2,516 |
| | **6,876** | 9,064 |

[a] Property mortgage includes $447 (£260) [2018 – $769 (£441)] of financing relating to land acquired in 2006. This same land is collateral for this mortgage and the mortgage bears interest at bank rate plus 0.90%, which at December 31, 2019 was 1.4% [2018 – 1.4%]. The property mortgage requires scheduled monthly repayments of accrued interest and principal and matures in June 2021.

[b] Other loans include loans of $8,904 [2018 – $10,811] provided by governmental authorities ("Government Loans") that bear interest of approximately 2.38% [2018 – 2.38%]. The Government Loans mature in April 2024 with accrued interest and principal repayable monthly.

## 15. LEASE LIABILITIES

The majority of the Corporation's leases relate to the rental of land and buildings. The Corporation has included the renewal options in the measurement when it is reasonably certain to exercise the renewal option.

The following table presents lease obligations for the Corporation:

| | **December 31 2019** |
|---|---|
| Current | **6,270** |
| Non-current | **39,794** |
| | **46,064** |

Below is a summary of the activity related to the Corporation's lease liabilities:

| | **Lease liabilities** |
|---|---|
| At January 1, 2019 | 24,338 |
| Additions | 25,167 |
| Interests on lease liabilities | 1,387 |
| Payments | (3,972) |
| Foreign exchange and other | (856) |
| **At December 31, 2019** | **46,064** |
| Less current portion | **6,270** |
| | **39,794** |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The following table presents the contractual undiscounted cash flows for lease obligations as of December 31, 2019:

| | **December 31 2019** |
|---|---|
| Less than one year | **6,649** |
| One to five years | **22,375** |
| Over five years | **30,523** |
| | **59,547** |

Expenses for short-term leases and leases of low-dollar value items are not material. There are no variable lease payments which are not included in the measurement of lease obligations. All extension options have been considered in the measurement of lease obligations.

## 16. BORROWING SUBJECT TO SPECIFIC CONDITIONS

The Corporation has received proceeds related to the development of its technologies and processes from Canadian government agencies. The contributions have been deducted in calculating the Corporation's investment in intangible assets, property plant and equipment or from the expense to which they relate. These amounts, plus, in certain cases, an implied return on the investment, are repayable as a percentage of the Corporation's revenues. The Corporation has included in borrowings subject to specific conditions the estimated amount of repayments in relation to the contributions received.

During 2019, the Corporation received $179 [2018 – $2,847] of government proceeds, of which $65 [2018 - $1,486] has been credited to the related assets, $21 [2018 – $190] has been credited to the related expense and $93 [2018 - $1,171] has been recorded in borrowings subject to specific conditions.

The proceeds are repayable as future royalty payments; a liability is recorded for the amounts received that will be repaid based on future estimated sales. During 2019, the Corporation repaid $960 [2018 – $1,021]. As at December 31, 2019, the Corporation recognized $25,291 [2018 – $25,427] as the amount repayable. The Corporation is eligible for additional government proceeds of $6,297 for the period from January 1, 2020 to March 31, 2020 based on approved expenditures.

## 17. OTHER LONG-TERM LIABILITIES AND PROVISIONS

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Net defined benefit plan deficits [note 23] | **12,739** | 12,012 |
| Provisions | **5,299** | 5,507 |
| Other | **4,813** | 4,792 |
| | **22,851** | 22,311 |
| Less current portion included in accounts payable, accured liabilities and provisions | **2,562** | 2,643 |
| | **20,289** | 19,668 |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The following table presents the movement in provisions:

| | Warranty | Environmental | Other provisions | Total |
|---|---|---|---|---|
| At December 31, 2017 | 1,176 | 2,703 | 1,722 | 5,601 |
| Additional provisions | 606 | – | 439 | 1,045 |
| Amount used | (588) | – | (479) | (1,067) |
| Unused amount reversed | (157) | (32) | (108) | (297) |
| Unwind of discount | – | 149 | – | 149 |
| Foreign currency translation | 48 | – | 28 | 76 |
| At December 31, 2018 | 1,085 | 2,820 | 1,602 | 5,507 |
| Additional provisions | 465 | – | 1,787 | 2,252 |
| Amount used | (480) | – | (939) | (1,419) |
| Unused amount reversed | (8) | (221) | (843) | (1,072) |
| Unwind of discount | – | 58 | – | 58 |
| Foreign currency translation | (26) | – | (1) | (27) |
| **At December 31, 2019** | **1,036** | **2,657** | **1,606** | **5,299** |

*Warranty*

During the normal course of its business, the Corporation assumes the cost of certain components under warranties offered on its products. This provision for a warranty is based on historical data associated with similar products and is recorded as a current liability. Nevertheless, conditions may change and a significant amount may need to be recorded.

*Environmental*

Provisions for environment liabilities have been recorded for costs related to site restoration obligations. Due to the long-term nature of the liability, the related long-term portion of the liability is included in long-term liabilities.

*Other*

This category of provisions includes provisions related to legal, onerous contracts, and other liabilities. The provisions are based on the Corporation's best estimate of the amount of the expenditure required to address the matters.

## 18. CHANGES IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

| | December 31 2018 | Cash flows | Foreign exchange | Other | **December 31 2019** |
|---|---|---|---|---|---|
| Debt due within one year | 44,393 | (1,720) | (717) | 6,188 | **48,144** |
| Long-term debt | 9,064 | (4,124) | (18) | 1,954 | **6,876** |
| Long-term liabilities and provisions | 19,668 | (44) | (430) | 1,095 | **20,289** |
| Borrowing subject to specific conditions | 25,427 | (803) | – | 667 | **25,291** |
| Lease liabilities | – | (3,972) | – | 43,766 | **39,794** |
| Total | 98,552 | (10,663) | (1,165) | 53,670 | **140,394** |

The "Other" column includes the effect of reclassification of non-current portion of interest bearing loans, borrowings and deferred revenues, allocation of borrowing subject to specific conditions to the related assets and expenses, changes in defined benefit plans, and the effect of interest accretion on interest bearing loans and borrowings, and lease liabilities.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

## 19. INCOME TAXES

The following are the major components of income tax expense:

| | 2019 | 2018 |
|---|---|---|
| **Current income tax expense** | | |
| Current tax expense for the year | **6,105** | 9,402 |
| | **6,105** | 9,402 |
| **Deferred income tax expense** | | |
| Origination and reversal of temporary difference | **11,565** | 15,709 |
| Impact of tax law changes | **(55)** | (51) |
| | **11,510** | 15,658 |
| Total income expense | **17,615** | 25,060 |

The Corporation's consolidated effective tax rate for the year ended December 31, 2019 was 20.7% [2018 – 21.9%]. The difference in the effective tax rates compared to the Corporation's statutory income tax rates were mainly caused by the following:

| | 2019 | 2018 |
|---|---|---|
| Income before income taxes | **84,996** | 114,180 |
| Income taxes based on the applicable tax rate of 25.8% in 2019 and 2018 | **21,929** | 29,458 |
| Adjustment to income taxes resulting from: | | |
| Adjustments in respect of prior years | **(1,463)** | 393 |
| Permanent differences and other | **(11)** | (153) |
| Income tax rates differentials on income of foreign operations | **(3,236)** | (4,582) |
| Changes in income tax rates | **(52)** | (56) |
| Unrecognized tax losses and temporary differences | **448** | – |
| Income tax expense | **17,615** | 25,060 |

Changes in the deferred tax components are adjusted through deferred income tax expense except for $5,181 [2018 – $10,048] of investment tax credits which is adjusted through cost of revenues and $54 [2018 – $1,857] for employee future benefits which is adjusted through other comprehensive income.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The following are the major components of deferred tax assets and liabilities:

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Operating loss carry forwards | **447** | (47) |
| Investment tax credits | **16,017** | 23,630 |
| Employee future benefits | **3,628** | 3,596 |
| Property, plant and equiptment and intangibles | **(53,657)** | (51,510) |
| Other | **2,940** | 2,559 |
| Deferred tax liabilities | **(30,625)** | (21,772) |

For the purposes of the above table, deferred tax assets are shown net of offsetting deferred tax liabilities where these occur in the same entity and jurisdiction, as follows:

| | **December 31 2019** | December 31 2018 |
|---|---|---|
| Deferred tax assets | **3,556** | 11,393 |
| Deferred tax liabilities | **(34,181)** | (33,165) |

The temporary difference associated with investments in subsidiaries and joint ventures, for which a deferred tax liability has not been recognized aggregates to $737,968 [2018 – $665,193].

## 20. SHARE CAPITAL

The authorized capital of the Corporation consists of an unlimited number of preference shares, issuable in series of which none are outstanding, and an unlimited number of common shares, with no par value.

**Common shares**

| | **Number** | **Amount** |
|---|---|---|
| Issued and fully paid: | | |
| **Outstanding at December 31, 2019 and December 31, 2018** | **58,209,001** | **254,440** |

**Net income per share**

| | **2019** | 2018 |
|---|---|---|
| Net income | **67,381** | 89,120 |
| Weighted average number of shares | **58,209,001** | 58,209,001 |
| Basic and diluted net income per share | **1.16** | 1.53 |

**Dividends declared**

On March 29, 2019, June 28, 2019, and September 30, 2019 the Corporation paid quarterly dividends on its 58,209,001 common shares of $0.10 per common share, amounting to $17,463. On December 31, 2019 the Corporation paid quarterly dividends on its 58,209,001 common shares of $0.105 per common share, amounting to $6,112.

For the year ended December 31, 2018, the Corporation declared and paid dividends on its common shares on March 30, 2018, June 29, 2018 and on September 28, 2018 of $0.085 per share amounting to $14,843 and on December 31, 2018 of $0.10 per share amounting to $5,821.

Subsequent to December 31, 2019, the Corporation declared dividends to holders of its common shares in the amount of $0.105 per common share payable on March 31, 2020, for shareholders of record at the close of business on March 20, 2020.

## 21. 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 options include a cash option feature that allows option holders to elect to receive an amount in cash equal to the intrinsic value, being the excess market price of the common share over the exercise price of the option, instead of exercising the option and acquiring the common shares. Options are granted at an exercise price equal to 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 20.0% 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 option holder's entitlement to fully vest. As at December 31, 2019 and December 31, 2018, there were no options granted and outstanding. The maximum number of options for common shares that is available to be granted under this plan is 1,673,341.

The Corporation has a deferred share unit plan ("DSU Plan") for certain executive officers ("Officers") which provides a structure for Officers to accumulate equity-like holdings in the Corporation. The DSU Plan allows certain Officers to participate in the growth of the Corporation by providing a deferred payment based on the value of a common share at the time of redemption. Each Officer receives deferred share units ("Units") based on their annual management incentive compensation. The Units are issued based on the Corporation's common share price at the time of issue. A third of the Units are vested and paid upon issuance and the remaining Units are vested and paid out equally on the anniversary date of issuance in the following two year periods or upon retiring. The cash value is equal to the common share price at the date of redemption, adjusted by any dividends paid on the common shares. For Units granted subsequent to May 1, 2016 a Total Shareholder Return ("TSR") performance element was introduced to reinforce the connection between remuneration and the interests of Shareholders, by motivating and rewarding participants for improving the long-term value of the Corporation. One third of the cash payment of the Units awarded for calendar 2016 and calendar years thereafter is made May 1 of the first calendar year following the date of the grant of the Units, another one third of cash payment is made May 1 of the second calendar year following the date of grant of the Units, and the remaining one third cash payment is made May 1 of the third calendar year following the date of grant of the Units. The number of Units that will actually vest ranges from 0% to 200% of the award remuneration granted and will be determined by the Corporation's three year TSR relative to a comparator group. The value each Officer ultimately receives would be determined by the number of Units earned, multiplied by the fair market value of the common share at the end of the performance period. As at December 31, 2019, 62,580 Units were outstanding at an accrued value of $661 [December 31, 2018 – $584]. The Corporation recorded compensation expense in relation to the DSU Plan during the year of $314 [2018 – $168].

## 22. FINANCIAL INSTRUMENTS

### Categories of financial instruments

Financial instruments are classified into one of the following categories: financial assets/financial liabilities at fair value through profit or loss, and financial assets/financial liabilities at amortized costs.

All financial instruments, including derivatives, are included on the consolidated statement of financial position, which are measured at fair value except for financial assets and liabilities measured at amortized costs.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The carrying values of the Corporation's financial instruments are classified as follows:

| | Financial assets at fair value through profit or loss[1] | Financial assets at amortized cost[2] | Total financial assets | Financial liabilities at fair value through profit of loss[3] | Financial liabilities at amortized cost[4] | Total financial liabilities |
|---|---|---|---|---|---|---|
| December 31, 2018 | 63,316 | 187,897 | 251,213 | 849 | 219,853 | 220,702 |
| **December 31, 2019** | **69,637** | **177,801** | **247,438** | **–** | **270,819** | **270,819** |

[1] Includes cash and cash equivalents and restricted cash
[2] Includes trade receivables and other receivables
[3] Includes derivatives contracts financial liabilities
[4] Includes bank indebtedness, accounts payable and accrued liabilities, long-term debt, lease liabilities, borrowings subject to specific conditions and trade receivables securitization financial liabilities

The Corporation has exposure to the following risks from its use of financial instruments:

- Market risk
- Credit risk
- Liquidity risk

**Market risk**

Market risk is the risk that changes in the market prices, such as foreign exchange rates and interest rates, will affect the Corporation's income or the value of its holdings of financial instruments. The Corporation's policy is not to utilize derivative financial instruments for trading or speculative purposes. The Corporation may utilize derivative instruments in the management of its foreign currency and interest rate exposures.

The Corporation thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include currency risk, interest rate risk, credit risk and liquidity risk. Where material, these risks are reviewed and monitored by the Board of Directors of the Corporation.

*Currency risk*

The Corporation operates internationally, which gives rise to a risk that its income, cash flows and shareholders' equity may be adversely impacted by fluctuations in foreign exchange rates. Currency risk arises because the amount of the local currency receivable or payable for transactions denominated in foreign currencies may vary due to changes in exchange rate ("transaction exposures") and because the non-Canadian dollar denominated financial statements of the Corporation's subsidiaries may vary on consolidation into the reporting currency of Canadian dollars ("translation exposures"). The Corporation uses derivative financial instruments to manage foreign exchange risk with the objective of minimizing transaction exposures and the resulting volatility of the Corporation's net income.

The most significant transaction exposures arise in the Canadian operations where significant portions of the revenues are transacted in US dollars. As a result, the Corporation may experience transaction exposures because of the volatility in the exchange rate between the Canadian and US dollar. Based on the Corporation's current US denominated net inflows as of December 31, 2019, fluctuations of +/- 1% would, everything else being equal, have an immaterial effect on net income for the year ended December 31, 2019. The Corporation may experience translation exposures on the consolidation of its US and European subsidiaries. Fluctuations of +/- 1% in the US dollar and British pound would, everything else being equal, have an effect on other comprehensive income of approximately $5,403.

*Interest rate risk*

The Corporation is exposed to interest rate risk in its floating rate bank indebtedness. As at December 31, 2019, $9,351 of the Corporation's total debt portfolio is subject to movements in floating interest rates. In addition, a portion of the Corporation's trade receivables securitization programs are exposed to interest rate fluctuations. The objective of the Corporation's interest rate management activities is to minimize the volatility of the Corporation's income. The Corporation monitors its exposure to interest rates and has not entered into any derivative contracts to manage this risk. A fluctuation in interest rates of 100 basis points (1%) would have impacted the amount of interest charged to net income during the year ended December 31, 2019 by approximately +/- $616.

**Credit risk**

Credit risk arises from cash and cash equivalents held with banks and financial institutions as well as credit exposure to clients, including outstanding trade receivables. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The objective of managing credit risk is to prevent losses in financial assets. The Corporation is also exposed to credit risk from the potential default by any of its counterparties on its foreign exchange forward contracts. The Corporation mitigates this credit risk by dealing with counterparties who are major financial institutions that the Corporation anticipates will satisfy their obligations under the contracts.

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. The Corporation sells the majority of its products to large international organizations with strong credit ratings. Therefore, the Corporation is not exposed to significant credit risk and overall the Corporation's credit risk has not changed significantly from the prior year.

The carrying amount of trade receivables is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated statements of income within administrative and general expenses. When a receivable balance is considered uncollectible, it is written off against the allowance for doubtful accounts. Subsequent recoveries of amounts previously written off are credited against administrative and general expenses.

*Derecognition of financial assets*

The Corporation sells a portion of its trade receivables through securitization programs or factoring transactions. During 2019, the Corporation sold receivables to various financial institutions in the amount of $314,936 [2018 – $314,117] for a discount of $2,053 [2018 – $2,224] representing an annualized interest rate of 2.76% [2018 – 3.21%].

As at December 31, 2019, trade receivables include receivables sold and financed through securitization transactions of $39,399 [2018 – $41,877] which do not meet the IFRS 9 derecognition requirements as the Corporation continues to be exposed to credit risk. These receivables are recognized in the consolidated statement of financial position even though they have been legally sold with a corresponding financial liability recorded in debt due within one year.

**Liquidity risk**

The Corporation's objective in managing liquidity risk is to ensure that there are sufficient committed loan facilities in order to meet its liquidity requirements at any point in time. The Corporation has in place a planning and budgeting process to help determine the funds required to support the Corporation's normal operating requirements on an ongoing basis, taking into account its anticipated cash flows from operations and its operating facility capacity. The primary sources of liquidity are the operating credit facility, trade receivables securitization program and cash provided by operations. Based on current funds available and expected cash flow from operating activities, management believes that the Corporation has sufficient funds available to meet its liquidity requirements at any point in time. However, if cash from operating activities is lower than expected or capital costs for projects exceed current estimates, or if the Corporation incurs major unanticipated expenses, it may be required to seek additional capital in the form of debt or equity or a combination of both.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

*Contractual maturity analysis*

The following table summarizes the contractual maturity of the Corporation's financial liabilities the table includes both interest and principal cash flows:

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Long-term debt[1] | 41,872 | 2,292 | 2,160 | 2,160 | 720 | – | 49,204 |
| Other long-term liabilities | 152 | 256 | 253 | 130 | 122 | 888 | 1,801 |
| Borrowing subject to specific conditions | 1,193 | 779 | 786 | 790 | 818 | 20,925 | 25,291 |
| | 43,217 | 3,327 | 3,199 | 3,080 | 1,660 | 21,813 | 76,296 |
| Interest payments | 203 | 147 | 96 | 45 | 4 | – | 495 |
| Total | 43,420 | 3,474 | 3,295 | 3,125 | 1,664 | 21,813 | 76,791 |

[1] The amount drawn of $39,399 on the Corporation's trade receivables securitization program is included in long-term debt in the Year 1 category

**Fair values**

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

*Cash and cash equivalents, trade receivables, bank indebtedness and accounts payable and accrued liabilities*

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

*Foreign exchange contracts*

The Corporation enters into forward foreign exchange contracts to mitigate future cash flow exposures in US dollars. Under these contracts the Corporation is obliged to purchase specific amounts at predetermined dates and exchange rates. These contracts are matched with anticipated operational cash flows in US dollars and Euros. There were no outstanding forward foreign exchange contracts as at December 31, 2019.

*Long-term debt*

The carrying amount of the Corporation's long-term debt of $9,351 approximates its fair value at December 31, 2019.

*Borrowings subject to specific conditions*

The Corporation has recognized $25,291 as the amount repayable to Canadian government agencies. The contributions are repayable as future royalty payments; a liability is recorded for the amounts received that will be repaid based on future estimated sales.

*Collateral*

As at December 31, 2019, the carrying amount of all of the financial assets that the Corporation has pledged as collateral for its long-term debt facilities was $48,748.

**Fair value hierarchy**

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

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

## 23. EMPLOYEE FUTURE BENEFITS

The Corporation provides retirement benefits through a variety of arrangements comprised principally of defined benefit and defined contribution plans that cover a substantial portion of employees in accordance with local regulations and practices. The most significant plans in terms of the benefits accrued to date by participants are career average and final average earnings plans and around 100% of the obligations accrued to date come from defined benefit plans in Canada.

**Defined Benefit Plans**

*Canada*

The Canadian defined benefit plans comprise of both career average and final average earnings plans which provide benefits to members in the form of a guaranteed level of pension payable for life. A majority of the plans are currently closed to new entrants. The level of pensions in the defined benefit plans depends on the member's length of service and salary at retirement age for final average earnings plans and salary during employment for career average plans. The defined benefit pension plans require contributions to be made to a separate trustee-administered fund which is governed by the Corporation. The Corporation is responsible for the administration of the plans assets and for the definition of the investment strategy. The Corporation reviews the level of funding in the defined benefit pension plans on an annual basis as required by local government legislation. Such review includes the asset-liability matching strategy and investment risk management policy. Actuarial valuations are required at least every three years. Depending on the jurisdiction and the funded status of the plan, actuarial valuations may be required annually. The most recent actuarial valuations for the various pension plans were completed as at January 1, 2018 and December 31, 2017.

Contributions are determined by the appointed actuary and cover the going-concern normal costs and deficits (established under the assumption that the plan will continue to be in force) or solvency deficits (established under the assumption that the plan stops its operations and is being liquidated), as prescribed by laws and actuarial practices. Under the laws in effect, minimum contributions are required to amortize the going-concern deficits over a period of fifteen years and solvency deficits over a period of five years. Temporary solvency relief measures are in place that allow for the amortization of solvency deficits over a period of up to ten years.

*US*

The US defined benefit plan provides benefits to members in the form of a guaranteed level of pension payable for life at retirement, and is currently closed to future accrual of benefits. The benefit payments are from a trustee-administered fund and plan assets held in trusts are governed by Internal Revenue Service ("IRS") regulations. Responsibility for governance of the plan, including investment decisions and contribution schedules, is also governed by IRS Regulations and lies with the Corporation. Actuarial valuations are required annually. Contributions are determined by appointed actuaries and cover normal cost and deficits as prescribed by law. Funding deficits are generally amortized over a period of seven years.

During 2019, the Corporation undertook steps to wind up the US defined benefit plan, which will be fully completed in 2020.

***Investment Policy***

The overall investment policy and strategy for the defined benefit pension plans is guided by the objective of achieving an investment return which, together with contributions, ensures that there will be sufficient assets to pay pension benefits as they fall due while also mitigating the risks of the plans. See below for more information about the Corporation's risk management initiatives.

The target asset allocation is determined based on expected economic and market conditions, the maturity profile of the plans' liabilities, the funded status of the respective plans and the plan stakeholders' tolerance to risk. Generally, the Corporation aims to have a portfolio mix of a combined 5% in money market securities, 20% in non-traditional equities, 30% in fixed income instruments and 45% in equity for the Canadian defined benefit plans and a portfolio mix of a combined 5% in cash, 20% in fixed income instruments, 60% in equity and 15% in alternative assets for the US defined benefit plan. As the plans mature and the funded status improves through cash contributions and anticipated excess equity returns, the Corporation intends to reduce the level of investment risk by investing in more fixed-income assets that better match the liabilities.

***Risk Management***

The Corporation's pension plans are exposed to various risks, including equity, interest rate, inflation, liquidity and longevity risks. Several risk strategies and policies have been put in place to mitigate the impact these risks could have on the funded status of defined benefit plans and on the future level of contributions by the Corporation. The following is a description of key risks together with the mitigation measures in place to address them.

*Equity risk*

Equity risk is the risk that results from fluctuations in equity prices. This risk is managed by maintaining diversification of portfolios across geographies, industry sectors and investment strategies.

*Interest rate risk*

Interest rate risk is the risk that results from fluctuations in the fair value of plan assets and liabilities due to movements in interest rates. This risk is managed by reducing the mismatch between the duration of plan assets and the duration of pension obligation.

This is accomplished by having a portion of the portfolio invested in long-term bonds. A decrease in corporate and/or government bond yields will increase plan liabilities, which will be partially offset by an increase in the value of the plans' bond holdings.

*Liquidity risk*

Liquidity risk is the risk stemming from holding assets which cannot be readily converted to cash when needed for the payment of benefits or to rebalance the portfolios. Liquidity risk is managed through investment in government bonds and equity futures.

*Longevity risk*

Longevity risk is the risk that increasing life expectancy results in longer-than-expected benefit payments resulting in an increase in the plans' liabilities. This risk is mitigated by using the most recent mortality tables to set the level of contributions.

The Corporation obtains actuarial valuations for its accrued benefit obligations and the fair value of plan assets for accounting purposes under IFRS as at December 31 of each year. In addition, the Corporation estimates movements in its accrued benefit liabilities at the end of each interim reporting period, based upon movements in discount rates and the rates of return on plan assets, as well as any significant changes to the plans. Adjustments are also made for payments made and benefits earned.

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

**Defined Contribution Plans**

The Corporation's management, administrative and certain unionized employees may participate in defined contribution pension plans. The Corporation contributes an amount expressed as a percentage of employees' contributions with such percentage varying by group.

The Corporation's expenses for defined contribution plans amounted to $7,145 for the year ended December 31, 2019 [2018 – $6,247].

**Other Benefit Plan**

The Corporation has another benefit plan in the US which includes retiree medical benefits that contribute to the health care coverage of certain employees and their beneficiaries after retirement. The other benefit plan is currently closed to new entrants. The post-retirement benefits cover all types of medical expenses including, but not limited to, cost of doctor visits, hospitalization, surgery and pharmaceuticals. The other benefit plan also provides for post-employment life insurance and compensated absences for eligible current employees, including vacation to be taken before retirement, if certain age and service requirements are met. The retirees contribute to the costs of the post-retirement medical benefits. The plan is not pre-funded and costs are incurred as amounts are paid.

The Corporation recognized total defined benefit costs related to its defined and other benefit plan as follows:

| | | **2019** | | 2018 |
|---|---|---|---|---|
| | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Current service cost | **2,091** | **–** | 2,471 | – |
| Net interest cost on net benefit liabitlity | **390** | **340** | 119 | 107 |
| Other | **425** | **–** | 475 | – |
| Total defined benefit cost recognized in net income | **2,906** | **340** | 3,065 | 107 |

The re-measurement components recognized in the statement of other comprehensive income for the Corporation's defined benefit plans comprise the following:

| | | **2019** | | 2018 |
|---|---|---|---|---|
| **Acturial losses (gains)** | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Return on pension assets (excluding amounts in net interest on defined benefit schemes) | **(12,495)** | **–** | 14,112 | – |
| Based on adjustment of liability assumptions | **12,571** | **–** | (6,477) | – |
| Due to liability experience adjustment | **119** | **–** | (575) | – |
| Total defined benefit loss recognized in the statement of other comprehensive income | **195** | **–** | 7,060 | – |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The following tables show the changes in the fair value of plan assets and the defined benefit obligation as recognized in the consolidated financial statements for the Corporation's benefit plans:

Changes in benefit plan assets of the Corporation's benefit plans

| | **2019** | | | 2018 |
|---|---|---|---|---|
| | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Fair value, beginning of year | **115,339** | **–** | 129,806 | – |
| Interest income on plan assets | **4,061** | **–** | 4,361 | – |
| Actual return on assets (excluding interest income on plan assets) | **12,495** | **–** | (14,112) | – |
| Employer contributions | **2,966** | **258** | 3,745 | 310 |
| Employee contributions | **219** | **–** | 250 | – |
| Benefit payments | **(6,705)** | **(258)** | (8,827) | (310) |
| Plan settlement | **(8,313)** | **–** | – | – |
| Administration costs | **(448)** | **–** | (704) | – |
| Exchange differences | **(298)** | **–** | 820 | – |
| End of year | **119,316** | **–** | 115,339 | – |

Changes in the benefit plan obligations of the Corporation's benefit plans

| | **2019** | | | 2018 |
|---|---|---|---|---|
| | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Beginning of year | **127,189** | **976** | 135,295 | 1,094 |
| Current service cost | **2,091** | **–** | 2,471 | – |
| Interest cost | **4,451** | **341** | 4,480 | 107 |
| Employee contributions | **219** | **–** | 250 | – |
| Actuarial losses (gains) in other comprehensive income from: | | | | |
| Changes in demographic assumptions | **65** | **–** | (308) | – |
| Changes in financial assumptions | **12,483** | **–** | (6,398) | – |
| Experience adjustments | **121** | **–** | (575) | – |
| Benefit payments | **(6,705)** | **(259)** | (8,827) | (310) |
| Plan settlement | **(8,313)** | **–** | – | – |
| Exchange difference | **(285)** | **(49)** | 801 | 85 |
| End of year | **131,316** | **1,009** | 127,189 | 976 |

Reconciliation of funded status of benefit plans to amounts recorded in the consolidated financial statements

| | **2019** | | | 2018 |
|---|---|---|---|---|
| | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Fair value of plan assets | **119,316** | **–** | 115,339 | – |
| Accrued benefit obligation | **(131,316)** | **(1,009)** | (127,189) | (976) |
| Net defined benefit liability | **(12,000)** | **(1,009)** | (11,850) | (976) |
| – Included in other long term liabilities and provisions | **(12,739)** | **(1,009)** | (12,012) | (976) |
| – Included in other assets | **739** | **–** | 162 | – |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

The Corporation expects to contribute approximately $2,446 in 2020 to all its defined benefit plans in accordance with normal funding policy. Because of market driven changes that the Corporation cannot predict, the Corporation could be required to make contributions in the future that differ significantly from its estimates.

**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]:

| | | **2019** | | 2018 |
|---|---|---|---|---|
| | **Defined benefit plans** | **Other benefit plan** | Defined benefit plans | Other benefit plan |
| Discount rate | **3.1%** | **3.0%** | 3.8% | 4.1% |
| Rate of compensation increase | **2.0%/3.0%** | **–** | 2.0%/3.0% | – |
| Mortality Table | | | | |
| Canadian defined benfits plans | **Club Vita Canada's 2016 VitaCurves, projected with improvement scale CPM-B** | | Club Vita Canada's 2016 VitaCurves, projected with improvement scale CPM-B | |
| US defined benefit plan | **MP-2014 mortality tables with MP-2019 projections** | | MP-2014 mortality tables with MP-2018 projections | |
| Other benefits plan | **MP-2014 mortality tables with MP-2019 projections (with blue collar adjustment)** | | MP-2014 mortality tables with MP-2018 projections (with blue collar adjustment) | |

The discount rate assumption used in determining the obligations for pension and other benefit plans was selected based on a review of current market interest rates of high-quality, fixed rate debt securities adjusted to reflect the duration of expected future cash outflows for pension benefit payments. At December 31, 2019, a 1.0% decrease in the discount rate used (all other assumptions remaining unchanged) could result in a $18,225 increase in the pension benefit obligation with a corresponding charge recognized in other comprehensive income in the year.

The Corporation funds health care benefit costs, shown under other benefit plan, on a pay as you go basis. For measurement purposes, a 6.0% annual rate of increase in the per capita cost of covered health care and dental benefits was assumed for 2019. The impact of applying a one-percentage-point increase or decrease in the assumed health care and dental benefit trend rates as at December 31, 2019 was nominal.

**Assets**

The weighted average asset allocations of the defined benefit plans at the measurement date, by asset category, are as follows:

| | **2019** | 2018 |
|---|---|---|
| Equity investments | **84%** | 81% |
| Fixed income investments | **15%** | 16% |
| Other investments | **1%** | 3% |
| | **100%** | 100% |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

**Defined benefit pension liability term**

| | Total |
|---|---|
| Defined benefits schedule for disbursement within 12 months | **6,220** |
| Defined benefits schedule for disbursement within 2 – 5 years | **28,314** |
| Defined benefits schedule for disbursement after 5 years or more | **36,910** |

## 24. SEGMENTED INFORMATION

Operating segments are defined as components of the Corporation for which separate financial information is available that is evaluated regularly by the chief operating decision maker in allocating resources and assessing performance. The chief operating decision maker of the Corporation is the President and Chief Executive Officer. The Corporation operates substantially all of its activities in one reportable segment, Aerospace, which include the design, development, manufacture, repair and overhaul, and sale of systems and components for defence and civil aviation. The Corporation evaluated the performance of its operating segments primarily based on net income before interest and income tax expense. The Corporation accounts for intersegment and related party sales and transfers, if any, at the exchange amount.

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

| | 2019 | 2018 |
|---|---|---|
| Sale of goods | **867,686** | 825,110 |
| Services | **148,533** | 141,643 |
| | **1,016,219** | 966,753 |

Timing of revenue recognition based on transfer of control is as follows:

| | 2019 | 2018 |
|---|---|---|
| At a point of time | **628,132** | 604,871 |
| Over time | **388,087** | 361,882 |
| | **1,016,219** | 966,753 |

The following table presents the aggregate amount of the revenues expected to be realized in the future from partially or fully unsatisfied performance obligations as at December 31, 2019 and 2018 as we perform under contracts at delivery or recognized over time. The amounts disclosed below represent the value of firm orders only. Such orders may be subject to future modifications that might impact the amount and/or timing of revenue recognition. The amounts disclosed below do not include constrained variable consideration, unexercised options or letters of intent.

Revenues expected to be recognized in:

| | 2019 | 2018 |
|---|---|---|
| Less than 24 months | **704,529** | 605,821 |
| Thereafter | **43,531** | 40,483 |

Revenues from the Corporation's two largest customers accounted for 39.1% of total sales for the year ended December 31, 2019 [December 31, 2018 – two largest customers accounted for 40.2% of total sales].

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

Geographic segments:

| | | | | 2019 | | | | 2018 |
|---|---|---|---|---|---|---|---|---|
| | **Canada** | **United States** | **Europe** | **Total** | Canada | United States | Europe | Total |
| Revenues | **366,565** | **322,970** | **326,684** | **1,016,219** | 320,838 | 325,739 | 320,176 | 966,753 |
| Export revenues[1] | **237,379** | **63,929** | **109,109** | **410,417** | 233,649 | 73,198 | 106,878 | 413,735 |

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

| | | | | 2019 | | | | 2018 |
|---|---|---|---|---|---|---|---|---|
| | **Canada** | **United States** | **Europe** | **Total** | Canada | United States | Europe | Total |
| Property, plant and equipment, right-of-use assets, intangible assets and goodwill | **200,484** | **191,411** | **191,409** | **583,304** | 189,294 | 185,032 | 152,401 | 526,727 |

## 25. COST REVENUES

| | 2019 | 2018 |
|---|---|---|
| Operating expenses | **810,156** | 772,151 |
| Amortization | **53,482** | 42,104 |
| Investment tax credits | **(4,834)** | (10,048) |
| Impairment (reversal) of inventories | **457** | (729) |
| | **859,261** | 803,478 |

## 26. ADMINISTRATIVE AND GENERAL EXPENSES

| | 2019 | 2018 |
|---|---|---|
| Salaries, wages and benefits | **36,299** | 35,736 |
| Administration and office expenses | **20,618** | 16,717 |
| Professional services | **3,130** | 3,179 |
| Amortization | **2,265** | 1,705 |
| | **62,312** | 57,337 |

## 27. INTEREST EXPENSE

| | 2019 | 2018 |
|---|---|---|
| Interest on bank indebtedness and long-term debt [notes 12 and 14] | **101** | 884 |
| Accretion charge on long-term debt and borrowings | **1,091** | 1,006 |
| Accretion on lease liabilities | **1,387** | – |
| Discount on sale of trade receivables | **2,053** | 2,224 |
| | **4,632** | 4,114 |

(unless otherwise stated, all amounts are in thousands of Canadian dollars)

## 28. OTHER COMPREHENSIVE INCOME

Other comprehensive income includes unrealized foreign currency translation gains and losses, which arise on the translation to Canadian dollars of assets and liabilities of the Corporation's foreign operations and net actuarial losses on defined benefit pension plans, net of tax. The Corporation recorded unrealized currency translation loss for the year ended December 31, 2019 of $18,839 [2018 – unrealized currency translation gain of $26,171] and net actuarial loss on defined benefit plans of $141 [2018 – net actuarial loss of $5,203]. These gains and losses are reflected in the consolidated statement of financial position and had no impact on net income for the year.

## 29. RELATED PARTY DISCLOSURE

### Transactions with related parties

During the year, the Corporation incurred consulting and cost recovery fees of $200 [2018 – $100] payable to a corporation controlled by the Chairman of the Board of Directors of the Corporation.

### Key management personnel

Key management includes members of the Board of Directors of the Corporation and executive officers, as they have the collective authority and responsibility for planning, directing and controlling the activities of the Corporation. The compensation expense for key management for services is as follows:

| | **2019** | 2018 |
|---|---|---|
| Short-term benefits | **2,931** | 3,185 |
| Post-employments benefits | **132** | 160 |
| Share-based payments | **170** | 242 |
| | **3,233** | 3,587 |

Short-term benefits include cash payments for base salaries, bonuses and other short-term cash payments. Post-employment benefits include the Corporation's contribution pension plan and pension adjustment for defined benefit plan. Share-based payments include amounts paid to Officers under the DSU Plan.

## 30. SUPPLEMENTARY CASH FLOW INFORMATION

| | **2019** | 2018 |
|---|---|---|
| **Net change in non-cash working capital** | | |
| Trade receivables | **12,183** | (13,224) |
| Contract assets | **(12,870)** | (18,335) |
| Inventories | **(21,096)** | 1,868 |
| Prepaid expenses and other | **(1,124)** | (5,412) |
| Accounts payable, accrued liabilities and provisions | **(3,974)** | (6,046) |
| | **(26,881)** | (41,149) |
| | | |
| Interest paid | **1,874** | 3,089 |
| Income taxes paid | **6,885** | 7,699 |

## 31. ADDITIONAL FINANCIAL INFORMATION

Included in other expenses is a foreign exchange loss of $1,874 [2018 – $2,993 gain] on the conversion of foreign currency denominated working capital balances and debt.

In 2019 the Corporation remeasured its previously held equity interest in a joint venture at fair value and recognized a gain of $881. In 2018 the Corporation recognized a gain of $10,651 in relation to a prior acquisition.

## 32. MANAGEMENT OF CAPITAL

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

As at December 31, 2019, total managed capital was $861,247, comprised of shareholders' equity attributable to equity holders of the Corporation of $812,499 and interest-bearing debt of $48,748.

The Corporation manages its capital structure and makes adjustments to it in light of economic conditions, the risk characteristics of the underlying assets and the Corporation's working capital requirements. In order to maintain or adjust its capital structure, the Corporation, upon approval from its Board of Directors, may issue or repay long-term debt, issue shares, repurchase shares through the normal course issuer bid, pay dividends or undertake other activities as deemed appropriate under the specific circumstances. The Board of Directors reviews and approves any material transactions out of the ordinary course of business, including proposals on acquisitions or other major investments or divestitures, as well as capital and operating budgets. Based on current funds available and expected cash flow from operating activities, management believes that the Corporation has sufficient funds available to meet its liquidity requirements at any point in time. However, if cash from operating activities is lower than expected or capital costs for projects exceed current estimates, or if the Corporation incurs major unanticipated expenses, it may be required to seek additional capital in the form of debt or equity or a combination of both. There were no changes in the Corporation's approach to capital management during the year.

The Corporation must adhere to covenants in its operating credit facility. As at December 31, 2019, the Corporation was in compliance with these covenants.

## 33. CONTINGENT LIABILITIES AND COMMITMENTS

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

As at December 31, 2019, capital commitments in respect of purchase of property, plant and equipment totalled $8,482, all of which had been ordered. There were no other material capital commitments at the end of the year.

## BOARD OF DIRECTORS AND EXECUTIVE OFFICERS

### EXECUTIVE OFFICERS

**N. Murray Edwards**
*Chairman*

**Phillip C. Underwood**
*President and*
*Chief Executive Officer*

**Elena M. Milantoni**
*Chief Financial Officer*

**Haydn R. Martin**
*Vice President,*
*Business Development,*
*Marketing and Contracts*

**Jim G. Powell**
*Vice President,*
*Mergers and Acquisitions,*
*and North American Operations*

**Jo-Ann C. Ball**
*Vice President,*
*Human Resources*

**Karen Yoshiki-Gravelsins**
*Vice President,*
*Corporate Stewardship and*
*Operational Excellence*

**Mark Allcock**
*Vice President,*
*Information Technology, and*
*Transformation*

**Craig A. Vaughan**
*Corporate Secretary*

### BOARD OF DIRECTORS

**N. Murray Edwards** (5)
*Chairman*
Magellan Aerospace Corporation
Mississauga, Ontario

**Phillip C. Underwood**
*President and Chief Executive Officer*
Magellan Aerospace Corporation
Mississauga, Ontario

**Beth M. Budd Bandler** (1, 2, 4)
*President*
Beth Bandler Professional Corporation
Toronto, Ontario

**Hon. William G. Davis** P.C., O.C., Q.C. (3)
*Counsel*
Davis Webb LLP
Brampton, Ontario

**Bruce W. Gowan** (1, 2, 3, 5)
*Corporate Director*
Huntsville, Ontario

**Larry G. Moeller** (4)
*President*
Kimball Capital Corporation
Calgary, Alberta

**Steven Somerville** (1, 2, 3, 4, 5)
*President*
Kerr Industries Limited
Oshawa, Ontario

### COMMITTEES OF THE BOARD

(1) Audit Committee
Chairman:
**Bruce W. Gowan**

(2) Governance and Nominating Committee
Chairman:
**Bruce W. Gowan**

(3) Human Resources and Compensation Committee
Chairman:
**Steven Somerville**

(4) Environmental and Health & Safety Committee
Chairman:
**Beth M. Budd Bandler**

(5) Pension Committee
Chairman:
**Steven Somerville**

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www.computershare.com

**STOCK LISTING**
Toronto Stock Exchange—TSX
Common Shares—MAL

**ANNUAL MEETING**
The Annual Meeting of the Shareholders of Magellan Aerospace Corporation will be held on Tuesday, May 5th, 2020 at 2:00 p.m. at The Living Arts Centre, 4141 Living Arts Drive, Mississauga, Ontario L5B 4B8

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