



**HÉROUX DEVTEK**   
**CREATING VALUE**

QUARTERLY REPORT — SECOND QUARTER ENDED SEPTEMBER 30, 2013





## MESSAGE TO SHAREHOLDERS

### Second quarter ended September 30, 2013

On behalf of the Board of Directors, I am pleased to present the financial results for Héroux-Devtek's second quarter ended September 30, 2013. The strength of the commercial aerospace market was the main driver, as sales in this market rose nearly 10%. However, uncertainty in the U.S. military market with reduced base defense budget funding and the ongoing sequestration resulted in a marked decline in sales of military products.

The main highlight of the quarter was the signature, by our wholly-owned subsidiary HDI Landing Gear USA Inc., of a Memorandum of Agreement ("MOA") with Boeing, to supply complete landing gear systems for the B-777 program. A multi-year contract is expected to be signed before the end of calendar 2013 and would be the largest contract ever for our landing gear operations. Under the terms of the MOA, HDI Landing Gear USA Inc. will supply complete landing gear systems, including the main and nose landing gear, and the nose landing gear drag strut. The MOA includes manufacturing parts for Boeing to sell in the aftermarket. Under the expected multi-year contract, deliveries would begin in early calendar 2017, with an option to extend the contract through 2028. This landmark achievement represents a major step up for Héroux-Devtek in the global supply chain, as it provides a solid foundation to leverage in our quest to sustain long-term growth

Consolidated sales from continuing operations amounted to \$56.4 million, down slightly from \$57.7 million in the second quarter of fiscal 2013. Fluctuations in the value of the Canadian currency versus the US currency increased second-quarter sales by \$0.4 million compared with last year's second quarter. Sales to the commercial aerospace market increased 8.8% to \$27.0 million resulting from new actuator business with Boeing on the B-777 program and production rate increases on the B-777 and A-320 programs, partially offset by lower aftermarket sales on the Bombardier CL-415 program. Sales to the military aerospace market declined 10.6% to \$29.4 million due to lower customer demand on certain programs, mainly the B-2, Global Hawk, F-15 and C-17, partially offset by new business with Boeing on the CH-47 Chinook helicopter program. Lower military sales also reflect a weak U.S. military market due to reduced base defense budget funding and the continued sequestration situation.

Gross profit was relatively stable, both in monetary terms and as a percentage of sales, as a higher under-absorption of manufacturing overhead costs resulting from lower military customer requirements was offset by a reduction in non-quality costs. Meanwhile, selling and administrative expenses rose mainly due to higher R&D expenses and professional fees, including those related to the B-777 MOA. As a result, earnings before interest, taxes, depreciation and amortization ("EBITDA") from continuing operations totalled \$6.3 million, or 11.1% of sales, compared with \$7.0 million, or 12.1% of sales, last year.

Net income from continuing operations was stable at \$2.6 million, or \$0.08 per diluted share, in the second quarter of fiscal 2014, versus \$2.6 million, or \$0.09 per diluted share, in the second quarter of fiscal 2013. In the second quarter of fiscal 2014, the Corporation recorded a favourable adjustment of deferred income tax liabilities of \$0.9 million.

For the first six months of fiscal 2014, consolidated sales from continuing operations reached \$119.4 million, versus \$121.5 million a year earlier. Currency variations increased sales by \$0.2 million but reduced gross profit by \$0.4 million in the first six months of fiscal 2014. EBITDA from continuing operations stood at \$14.0 million, or 11.7% of sales, compared with \$15.3 million, or 12.6% of sales, a year earlier. Net income from continuing operations totalled \$5.4 million, or \$0.17 per diluted share, versus \$5.6 million, or \$0.18 per diluted share, in the prior year.



As at September 30, 2013, Héroux-Devtek's balance sheet remained healthy with cash and cash equivalents of \$92.7 million, or \$2.94 per share. At that same date, total debt was \$62.2 million, including \$22.7 million drawn against the Corporation's authorized Credit Facility of \$150.0 million, but excluding net deferred financing costs. As a result, the Corporation's net cash position stood at \$30.5 million as at September 30, 2013.

As at September 30, 2013, Héroux-Devtek's funded (firm orders) backlog stood at \$347 million, versus \$361 million at the beginning of the fiscal year, and remains well diversified. The decline is essentially attributable to the weakness of the U.S. military market.

Conditions remain favourable in the commercial aerospace market. Large commercial aircraft manufacturers continue to proceed with production rate increases for certain leading programs and are forecasting higher deliveries in calendar 2013 than a year earlier. Their backlogs remain strong, representing seven to eight years of production at current rates. In the business jet market, key indicators point to a recovery and shipments should experience sustained growth in the next few years driven by a better economy and the introduction of several new aircraft, including three models for which Héroux-Devtek is currently developing the landing gear. The military aerospace market is expected to remain difficult. Given the uncertainty regarding the duration of sequestration, the Corporation may continue to be affected by U.S. defense cutbacks beyond the current fiscal year, despite having a diversified military portfolio, balanced between new component manufacturing and aftermarket products and services, that should lessen this impact.

Through its solid reputation as a world-class provider of integrated services, Héroux-Devtek is well positioned to seize opportunities that will arise in the landing gear market. In the short-term, the joint effect of U.S. military spending restrictions, the persistent sequestration and the government shutdown in October, will further impact consolidated sales for the fiscal year ending March 31, 2014, which we now expect to be slightly lower than last year, offsetting robust commercial aerospace activity that should yield sales growth of approximately 10% in this market. Given the weak military market, we must proactively optimize our asset utilization and adapt supply to demand, as evidenced by the recent workforce reduction. Over the long run, Héroux-Devtek's financial strength is a key factor to shareholder value creation, as capital will be deployed, internally and through strategic acquisition, in initiatives that will further enhance our product and service offering.

Gilles Labbé  
President and Chief Executive Officer  
November 8, 2013



## **INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**For the quarter ended September 30, 2013**

**Notice of Disclosure of Non-Auditor Review of Interim Condensed Consolidated Financial Statements for the quarters ended September 30, 2013 and 2012.**

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Pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators, if the external auditors have not performed a review of the financial statements, the financial statements must be accompanied by a notice indicating that they have not been reviewed by the external auditors.

The accompanying unaudited interim condensed consolidated financial statements of the Corporation for the quarters ended September 30, 2013 and 2012, have been prepared in accordance with the International Accounting Standard 34, Interim Financial Reporting and are the responsibility of the Corporation's management.

The Corporation's external auditors, Ernst & Young LLP, have not performed a review of these interim condensed consolidated financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of financial statements by the external auditors of an entity.

November 8, 2013.

**CONSOLIDATED BALANCE SHEETS**

As at September 30, 2013 and March 31, 2013

(In thousands of Canadian dollars) (Unaudited)

	Notes	September 30, 2013	March 31, 2013
<b>Assets</b>	12		
<b>Current assets</b>			
Cash and cash equivalents	9	\$ 92,678	\$ 101,256
Accounts receivable		36,845	46,550
Income tax receivable		737	858
Inventories		101,251	100,817
Derivative financial instruments	10	772	2,935
Other current assets	11	11,885	12,577
		<b>244,168</b>	<b>264,993</b>
<b>Property, plant and equipment, net</b>	5	<b>78,430</b>	<b>78,186</b>
<b>Finite-life intangible assets, net</b>	5	<b>31,379</b>	<b>26,472</b>
<b>Derivative financial instruments</b>	10	<b>106</b>	<b>284</b>
<b>Deferred income tax assets</b>		<b>1,702</b>	<b>—</b>
<b>Goodwill</b>		<b>19,255</b>	<b>19,180</b>
<b>Total assets</b>		<b>\$ 375,040</b>	<b>\$ 389,115</b>
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 37,552	\$ 44,302
Accounts payable - other		1,624	2,378
Provisions		8,869	8,901
Progress billings		5,938	10,211
Income tax payable		132	2,549
Derivative financial instruments	10	1,196	1,655
Current portion of long-term debt	12	3,405	3,808
		<b>58,716</b>	<b>73,804</b>
<b>Long-term debt</b>	12	<b>57,650</b>	<b>59,149</b>
<b>Provisions</b>		<b>4,686</b>	<b>5,071</b>
<b>Progress billings</b>		<b>1,591</b>	<b>2,068</b>
<b>Derivative financial instruments</b>	10	<b>569</b>	<b>909</b>
<b>Deferred income tax liabilities</b>		<b>12,959</b>	<b>12,425</b>
<b>Other liabilities – Pension and other retirement benefit plans</b>		<b>7,555</b>	<b>13,036</b>
		<b>143,726</b>	<b>166,462</b>
<b>Shareholders' equity</b>			
Issued capital	13	25,498	25,365
Contributed surplus	13	1,285	1,222
Accumulated other comprehensive income	14	3,063	2,647
Retained earnings		201,468	193,419
		<b>231,314</b>	<b>222,653</b>
		<b>\$ 375,040</b>	<b>\$ 389,115</b>

Discontinued operations and Commitments (notes 4 and 16)

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONSOLIDATED STATEMENTS OF INCOME**

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars, except per share data) (Unaudited)

	Notes	Quarters ended September 30,		Six months ended September 30,	
		2013	2012	2013	2012
			(Restated - note 3)		(Restated - note 3)
Continuing operations	4				
Sales		\$ 56,402	\$ 57,684	\$ 119,374	\$ 121,464
Cost of sales	5, 6	48,531	49,802	102,351	103,085
Gross profit		7,871	7,882	17,023	18,379
Selling and administrative expenses	6	4,810	3,997	9,451	9,463
Operating income		3,061	3,885	7,572	8,916
Financial expenses	7	963	1,073	1,686	2,195
Income before income tax expense from continuing operations		2,098	2,812	5,886	6,721
Income tax expense (recovery)		(486)	167	488	1,130
Net income from continuing operations		2,584	2,645	5,398	5,591
Discontinued operations	4	—	110,000	—	113,258
Net income		\$ 2,584	\$ 112,645	\$ 5,398	\$ 118,849
Earnings per share from continuing operations – basic	8	\$ 0.08	\$ 0.09	\$ 0.17	\$ 0.18
Earnings per share from continuing operations – diluted	8	\$ 0.08	\$ 0.09	\$ 0.17	\$ 0.18
Earnings per share – basic	8	\$ 0.08	\$ 3.68	\$ 0.17	\$ 3.89
Earnings per share – diluted	8	\$ 0.08	\$ 3.64	\$ 0.17	\$ 3.86

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

For the quarters ended September 30

	Notes	2013	2012
	14		(Restated - note 3)
Other comprehensive income from continuing operations:			
Items that may be reclassified to net income			
Loss arising from translating the financial statements of foreign operations	\$	(2,304)	\$ (1,601)
Cash flow hedges:			
Net gains on valuation of derivative financial instruments		2,845	4,864
Net (gains) losses on derivative financial instruments transferred to net income		28	(2,022)
Deferred income taxes		(768)	(751)
		2,105	2,091
Gains on hedge of net investments in U.S. operations		473	815
Deferred income taxes		(62)	(106)
		411	709
Items that are never reclassified to net income			
Defined benefit pension plans:			
Actuarial gains (losses)		4,336	(789)
Net change in asset limit and minimum funding requirements		(520)	—
Deferred income taxes		(1,023)	210
		2,793	(579)
Other comprehensive income from continuing operations		3,005	620
Discontinued operations	4	—	982
Other comprehensive income	\$	3,005	\$ 1,602
Comprehensive income			
Continuing operations:			
Net income	\$	2,584	\$ 2,645
Other comprehensive income		3,005	620
Comprehensive income from continuing operations		5,589	3,265
Discontinued operations:			
Net income	4	—	110,000
Other comprehensive income	4	—	982
Comprehensive income from discontinued operations		—	110,982
Comprehensive income	\$	5,589	\$ 114,247

The accompanying notes are an integral part of these interim condensed consolidated financial statements.



**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

For the six-month periods ended September 30

	Notes	2013	2012
	14		(Restated - note 3)
Other comprehensive income from continuing operations:			
Items that may be reclassified to net income			
Gain (loss) arising from translating the financial statements of foreign operations	\$	1,489	\$ (894)
Cash flow hedges:			
Net gains (losses) on valuation of derivative financial instruments		(590)	3,480
Net gains on derivative financial instruments transferred to net income		(492)	(4,071)
Deferred income taxes		284	149
		(798)	(442)
Gains (losses) on hedge of net investments in U.S. operations		(315)	363
Deferred income taxes		40	(46)
		(275)	317
Items that are never reclassified to net income			
Defined benefit pension plans:			
Actuarial gains (losses)		4,142	(2,687)
Net change in asset limit and minimum funding requirements		(520)	—
Deferred income taxes		(971)	716
		2,651	(1,971)
Other comprehensive income (loss) from continuing operations		3,067	(2,990)
Discontinued operations	4	—	2,181
Other comprehensive income (loss)	\$	3,067	\$ (809)
Comprehensive income			
Continuing operations:			
Net income	\$	5,398	\$ 5,591
Other comprehensive income (loss)		3,067	(2,990)
Comprehensive income (loss) from continuing operations		8,465	2,601
Discontinued operations:			
Net income	4	—	113,258
Other comprehensive income	4	—	2,181
Comprehensive income from discontinued operations		—	115,439
Comprehensive income	\$	8,465	\$ 118,040

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

For the six-month period ended September 30, 2013

	Notes	Issued capital	Contributed surplus	Accumulated other comprehensive income	Retained earnings	Shareholders' equity
<b>Balance as at March 31, 2013</b>		\$ 25,365	\$ 1,222	\$ 2,647	\$ 193,419	\$ 222,653
Common shares issued under the Stock purchase and ownership incentive plan	13	133	—	—	—	133
Stock-based compensation expense	13	—	63	—	—	63
Net income		—	—	—	5,398	5,398
Other comprehensive income		—	—	416	2,651	3,067
<b>Balance as at September 30, 2013</b>		\$ 25,498	\$ 1,285	\$ 3,063	\$ 201,468	\$ 231,314

For the six-month period ended September 30, 2012

	Notes	Issued capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings	Shareholders' equity
<b>Balance as at March 31, 2012</b>		\$ 102,202	\$ 3,059	\$ 2,515	\$ 136,191	\$ 243,967
Common shares:	13					
Issued under the Stock option plan		2,214	(503)	—	—	1,711
Cancelled under Stock option plan		—	(258)	—	—	(258)
Issued under the Stock purchase and ownership incentive plan		168	—	—	—	168
Stock-based compensation expense	13	—	193	—	—	193
Net income <sup>(1)</sup>		—	—	—	118,849	118,849
Other comprehensive income (loss) <sup>(1)</sup>		—	—	1,162	(1,971)	(809)
<b>Balance as at September 30, 2012</b>		\$ 104,584	\$ 2,491	\$ 3,677	\$ 253,069	\$ 363,821

<sup>(1)</sup> Restated - note 3

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

	Notes	Quarters ended September 30,		Six months ended September 30,	
		2013	2012	2013	2012
			(Restated - note 3)		(Restated - note 3)
<b>Cash and cash equivalents provided by (used for):</b>					
<b>Operating activities</b>					
Net income from continuing operations		\$ 2,584	\$ 2,645	\$ 5,398	\$ 5,591
Items not requiring an outlay of cash:					
Amortization expense	6	3,193	3,104	6,429	6,344
Deferred income taxes		(1,791)	(672)	(1,168)	(779)
Gain on sale of property, plant and equipment		(41)	(80)	(40)	(97)
Non-cash financial expenses	7	713	934	1,155	1,746
Stock-based compensation expense	13	27	78	63	193
Cash flows from continuing operations		4,685	6,009	11,837	12,998
Net change in non-cash items related to continuing operations	15	(1,096)	(4,602)	(5,208)	(8,635)
<b>Cash flows related to operating activities from continuing operations</b>		<b>3,589</b>	<b>1,407</b>	<b>6,629</b>	<b>4,363</b>
Cash flows related to operating activities from discontinued operations		—	(675)	(1,641)	8,273
<b>Cash flows related to operating activities</b>		<b>3,589</b>	<b>732</b>	<b>4,988</b>	<b>12,636</b>
<b>Investing activities</b>					
Additions to property, plant and equipment		(3,340)	(2,972)	(6,521)	(6,443)
Net decrease (increase) in finite-life intangible assets		(2,269)	607	(5,264)	(2,501)
Proceeds on disposal of property, plant and equipment		47	88	47	92
Net proceeds from sale of discontinued operations	4	—	272,796	—	272,796
Cash flows related to investing activities of discontinued operations		—	(2,919)	—	(4,294)
<b>Cash flows related to investing activities</b>		<b>(5,562)</b>	<b>267,600</b>	<b>(11,738)</b>	<b>259,650</b>
<b>Financing activities</b>					
Repayment of long-term debt	4	(486)	(37,715)	(3,047)	(40,438)
Issuance of common shares	13	66	1,794	133	1,879
Cash flows related to financing activities of discontinued operations		—	(1,521)	—	(3,208)
<b>Cash flows related to financing activities</b>		<b>(420)</b>	<b>(37,442)</b>	<b>(2,914)</b>	<b>(41,767)</b>
<b>Effect of changes in exchange rates on cash and cash equivalents</b>		<b>(1,625)</b>	<b>(2,162)</b>	<b>1,086</b>	<b>(1,300)</b>
<b>Change in cash and cash equivalents during the periods</b>		<b>(4,018)</b>	<b>228,728</b>	<b>(8,578)</b>	<b>229,219</b>
<b>Cash and cash equivalents at beginning of periods</b>		<b>96,696</b>	<b>62,498</b>	<b>101,256</b>	<b>62,007</b>
<b>Cash and cash equivalents at end of periods</b>		<b>\$ 92,678</b>	<b>\$ 291,226</b>	<b>\$ 92,678</b>	<b>\$ 291,226</b>
<b>Interest and taxes reflected in operating activities:</b>					
Interest paid for continuing operations		\$ 360	\$ 333	\$ 751	\$ 677
Interest received from continuing operations		\$ 111	\$ 194	\$ 221	\$ 228
Income taxes paid for continuing operations		\$ 469	\$ 948	\$ 1,130	\$ 4,718
Interest paid for discontinued operations		\$ —	\$ 603	\$ —	\$ 1,255
Income taxes paid for discontinued operations		\$ —	\$ 1,201	\$ 1,641	\$ 432

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

## NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the periods ended September 30, 2013 and 2012

(In thousands of Canadian dollars, except share data) (Unaudited)

### Note 1. Nature of activities and corporate information

Héroux-Devtek Inc. is incorporated under the laws of Québec. Its head office is domiciled at Complexe St-Charles, 1111 St-Charles Street West, suite 658, East Tower, Longueuil (Québec), Canada. Héroux-Devtek Inc. and its subsidiaries (the "Corporation") specialize in the design, development, manufacture, repair and overhaul of aircraft landing gear, hydraulic flight control actuators and fracture-critical components. It also includes the manufacture of electronic enclosures, heat exchangers and cabinets for airborne radar, electro-optic systems and aircraft controls through its Magtron operations (see Note 4 – Discontinued operations).

### Note 2. Basis of preparation

The interim condensed consolidated financial statements for the quarter ended September 30, 2013 were prepared in accordance with IAS 34, *Interim Financial Reporting*. Therefore, certain information and disclosures have been omitted or condensed. The same accounting policies and methods of computation were followed in the preparation of these interim condensed consolidated financial statements as were followed in the preparation of the most recent annual audited consolidated financial statements, except for the changes in accounting policies described in note 3. Accordingly, these interim condensed consolidated financial statements for the quarter ended September 30, 2013 should be read together with the annual audited consolidated financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended March 31, 2013.

These interim condensed consolidated financial statements were approved for issue by the Board of Directors of the Corporation on November 7, 2013.

### Note 3. Changes in accounting policies

On April 1, 2013, the Corporation adopted retrospectively the standards below in accordance with required changes from the International Accounting Standard Board. The adoption of these new standards did not have a material impact on prior periods comparative figures.

#### IAS 1 *Financial Statement Presentation*

The amended IAS 1, *Presentation of Financial Statements* was adopted retrospectively effective April 1<sup>st</sup>, 2013. The principal change resulting from the amendments to IAS 1 is the requirement to present separately other comprehensive income items that may be reclassified to income from other comprehensive items that will not be reclassified to income in the consolidated statement of comprehensive income.

#### IFRS 13 *Fair Value Measurements*

The IFRS 13, *Fair Value Measurements* was adopted retrospectively effective April 1<sup>st</sup>, 2013, and is a new and comprehensive standard that sets out a framework for measuring at fair value and that provides guidance on required disclosures about fair value measurements.

#### IAS 19 *Employee Benefits*

The amended IAS 19, *Employee Benefits* was adopted retrospectively effective April 1<sup>st</sup>, 2013. Amongst other changes, the amendments require entities to compute the financing cost component of defined benefit plans by applying the discount rate used to measure post-employment benefit obligations to the net post-employment benefit obligations (usually, the present value of defined benefit obligations less the fair value of plan assets). Also, the net interest cost is now presented in the financial expenses. Furthermore, the amendments to IAS 19 enhance the disclosure requirements for defined benefit plans, providing additional information about the characteristics of defined benefit plans and the risks that entities are exposed to, through participation in those plans. The changes in accounting policy have been accounted for retrospectively in accordance with the transition rules of the amended IAS 19 and the additional required disclosures will be provided in our annual consolidated financial statements for fiscal year 2014.

The impact of the adoption of the amended IAS 19, *Employee Benefits* on the consolidated statement of income and consolidated statement of comprehensive income for the quarter and six-month period ended September 30, 2012 are as follows:

	Quarter ended	Six months ended
• Decrease of cost of sales	\$ (17)	\$ (35)
• Increase of financial expenses	126	252
• Decrease of income tax expense	(30)	(59)
• Decrease of net income from continuing operations and net income	(79)	(158)
• Decrease of actuarial losses, net of income taxes	(79)	(158)
• Increase of other comprehensive income from continuing operations and other comprehensive income	79	158

#### Note 4. Discontinued operations

On July 16, 2012, the Corporation executed a definitive agreement for the sale of substantially all of its Aerostructure and Industrial product line operations to Precision Castparts Corporation ("PCC"), a public company traded on the New York Stock Exchange ("sale transaction"). The net assets acquired by PCC include the Corporation's Dorval (Quebec), Querétaro (Mexico) and Arlington (Texas) Aerostructure product line manufacturing sites, as well as the Cincinnati (Ohio) Industrial product line manufacturing sites. Prior to the sale transaction, the Aerostructure product line was part of the Corporation's Aerospace segment, while the Industrial product line formed the Industrial segment. Therefore, all of the operations of the businesses sold are now excluded from the Corporation's segmented information. Following this sale transaction, the Corporation is now operating only in the Aerospace segment and is comprised essentially of the landing gear product line and Magtron operations.

The sale transaction was concluded on August 31, 2012 with gross sale proceeds, including post-closing adjustments, of \$297.8 million paid in cash. Taking into consideration the post-closing adjustments finalized during the last semester of fiscal year 2013, the net gain amounted to \$111.2 million.

Last year, concurrently to the sale transaction, the Corporation proceeded with a \$16 million reduction of finance lease obligations and the repayment of a \$1 million governmental authorities' loan related to the businesses sold. The Corporation also proceeded with a partial repayment of US\$37.5 million (\$37.0 million) against the Syndicated Banks' Credit Facility ("Credit Facility") and repurchased two of the three interest rate swap agreements in place, representing a total notional amount of US \$30 million, for a total cost of \$1.7 million which was recorded as transaction related costs to the sale transaction.

Following the sale transaction explained above, income and expenses from discontinued operations before August 31, 2012 are reported separately from income and expenses from continuing operations, down to the level of net income in the consolidated statements of income for all quarters of the fiscal year ended March 31, 2013.

Net income related to the discontinued operations for the quarter and six-month period ended September 30, 2012, are presented as follows:

	Quarter ended	Six months ended
Sales	\$ 22,634	\$ 58,081
Cost of sales	16,915	45,423
Gross profit	5,719	12,658
Selling and administrative expenses	1,254	3,207
Operating income	4,465	9,451
Financial expenses	411	1,047
Gain from sale of discontinued operations	157,686	157,686
Income before income tax expense from discontinued operations	161,740	166,090
Income tax expense related to discontinued operations	1,180	2,272
Income tax expense related to the gain from sale of discontinued operations	50,560	50,560
Net income from discontinued operations	\$ 110,000	\$ 113,258
Earnings per share from discontinued operations - basic	\$ 3.59	\$ 3.71
Earnings per share from discontinued operations - diluted	\$ 3.55	\$ 3.67

Comprehensive income related to the discontinued operations for the quarter and six-month period ended September 30, 2012, are presented as follows:

	Quarter ended	Six months ended
Other comprehensive income:		
Items that may be reclassified to net income		
Gain (loss) arising from translating the financial statements of foreign operations	\$ (1,276)	\$ 760
Cash flow hedges:		
Net gains on valuation of derivative financial instruments	—	1,355
Net losses on derivative financial instruments transferred to net income	1,569	—
Deferred income taxes	(416)	(365)
	1,153	990
Gains on hedge of net investments in U.S. operations	1,270	495
Deferred income taxes	(165)	(64)
	1,105	431
Other comprehensive income from discontinued operations	982	2,181
Net income from discontinued operations	110,000	113,258
Comprehensive income from discontinued operations	\$ 110,982	\$ 115,439

Last year, following the sale transaction, the Board of Directors of the Corporation approved, on November 8, 2012, a special cash distribution of \$5.00 per share paid on December 19, 2012 to shareholders of record on November 20, 2012 ("special distribution").

The special distribution to shareholders of \$5.00 per share which represented a cash distribution of \$157,495 (based on 31,498,905 common shares outstanding on November 20, 2012) made on December 19, 2012 was composed of and recorded as an issued capital reduction of \$2.70 per share (\$85,047) and of a special cash dividend of \$2.30 per share (\$72,448) recorded against retained earnings. The transaction costs related to this special distribution to shareholders amounted to \$193, net of income taxes, of which \$105 was recorded as a reduction of issued capital and \$88 against retained earnings.

#### **Note 5. Government assistance**

During the quarter ended September 30, 2013, the Corporation recorded as government assistance for continuing operations an amount of \$1,056 as a reduction of incurred cost of sales and selling and administrative expenses (\$578 in 2012) and an amount of \$1,204 (\$931 in 2012) as a reduction of the related property, plant and equipment or capitalized development costs, presented under Finite-life intangible assets.

During the six-month period ended September 30, 2013, the Corporation recorded as governmental assistance for continuing operations an amount of \$1,516 as a reduction of incurred cost of sales and selling and administrative expenses (\$1,132 in 2012) and an amount of \$1,514 (\$1,304 in 2012) as a reduction of the related property, plant and equipment or capitalized development costs, presented under Finite-life intangible assets.



**Note 6. Cost of sales, selling and administrative expenses**

The main components of these expenses related to continuing operations for the quarters and six-month periods ended September 30, are as follows:

	Quarters ended September 30,		Six months ended September 30,	
	2013	2012	2013	2012
		(Restated - note 3)		(Restated - note 3)
Raw materials and purchased parts	\$ 22,735	\$ 23,692	\$ 47,898	\$ 47,260
Employee costs	20,804	20,301	44,842	44,807
Amortization of property, plant and equipment and finite-life intangible assets	3,193	3,104	6,429	6,344
Others	6,609	6,702	12,633	14,137
	\$ 53,341	\$ 53,799	\$ 111,802	\$ 112,548

Foreign exchange gains or losses resulting from the translation of net monetary items denominated in foreign currencies are included in the Corporation's selling and administrative expenses. During the quarter ended September 30, 2013, the foreign exchange loss included in the Corporation's selling and administrative expenses amounted to \$109 (\$15 in 2012) while it represented a gain of \$411 (\$11 in 2012) for the six-month period ended September 30, 2013.

**Note 7. Financial expenses**

Financial expenses for the quarters and six-month periods ended September 30, comprise the following:

	Quarters ended September 30,		Six months ended September 30,	
	2013	2012	2013	2012
		(Restated - note 3)		(Restated - note 3)
Interest expense	\$ 219	\$ 226	\$ 471	\$ 466
Interest accretion on governmental authorities loans	464	438	933	885
Interest on net defined benefit obligations	115	126	229	252
Amortization of deferred financing costs (note 12)	110	110	220	220
Standby fees	142	107	281	211
Other interest accretion expense and discount rate adjustments	24	260	(227)	389
	1,074	1,267	1,907	2,423
Interest income on cash and cash equivalents	111	194	221	228
	\$ 963	\$ 1,073	\$ 1,686	\$ 2,195

## Note 8. Earnings per share

The following table sets forth the elements used to compute basic and diluted earnings per share for the quarters and six-month periods ended September 30:

	Quarters ended September 30,		Six months ended September 30,	
	2013	2012	2013	2012
Weighted-average number of common shares outstanding	31,525,974	30,626,070	31,521,584	30,537,527
Effect of dilutive stock options of the Corporation	162,048	358,911	156,085	286,387
Weighted-average number of common diluted shares outstanding	31,688,022	30,984,981	31,677,669	30,823,914

The diluted earnings per share calculation does not take into consideration the potential dilutive effect of certain stock options of the Corporation since their impact is anti-dilutive. During the quarter and six-month period ended September 30, 2013, no stock options of the Corporation's plan (none for the quarter and 266,000 for the six-month period in 2012) were excluded from the diluted earnings per share calculation.

## Note 9. Cash and cash equivalents

	September 30, 2013		March 31, 2013	
Cash at banks	\$	87,678	\$	91,236
Short-term deposits		5,000		10,020
	\$	92,678	\$	101,256

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods up to three months and earn interest at the respective short-term deposit rates.

## Note 10. Derivative financial instruments

### Forward foreign exchange contracts

As at September 30, 2013, the Corporation had forward foreign exchange contracts to sell US\$115.1 million at a weighted-average rate of 1.0321 (Canadian dollar over U.S. dollar, "cad/usd"). As at March 31, 2013 and September 30, 2012, these contracts totalled US\$123.5 million at a weighted-average rate of 1.0325 cad/usd and US\$136.3 million at a weighted-average rate of 1.0498 cad/usd, respectively. As at September 30, 2013, these contracts mature at various dates between October 2013 and March 2017, with the majority maturing this and next fiscal year.

As at September 30, 2013 and March 31, 2013, the Corporation had also entered into forward foreign exchange contracts to sell US\$1.4 million at a weighted-average rate of 1.2275 cad/usd and US\$4.7 million at a weighted-average rate of 1.2262 cad/usd, respectively. These contracts cover foreign exchange risk related to certain embedded derivative financial instruments and they all mature this fiscal year.

### Interest rate swap agreements

As at September 30, 2013, March 31, 2013 and September 30, 2012, the Corporation had entered into one interest rate swap agreement for a notional amount of US\$10 million, which fix the Libor rate at 3.91%, and will mature in December 2015.

In August 2012, following the sale transaction, the Corporation repurchased for a cost of US\$1,695, two interest rate swap agreements for a total notional amount of US\$30 million (see Note 4 - Discontinued operations).

**Note 11. Other current assets**

	September 30, 2013	March 31, 2013
Investment and other tax credits receivable	\$ 8,869	\$ 9,051
Sales tax receivable	1,175	1,405
Deposits on machinery and equipment (note 16)	144	234
Prepaid expenses	1,304	1,540
Others	393	347
	<b>\$ 11,885</b>	<b>\$ 12,577</b>

**Note 12. Long-term debt**

	September 30, 2013	March 31, 2013
Senior Secured Syndicated Revolving Credit Facility ("Credit Facility") of up to \$150,000 - either in Canadian or U.S. currency equivalent, maturing on March 15, 2016, which bears interest at Libor plus 1.875% representing an effective interest rate of 2.1% as at September 30, 2013 and March 31, 2013, secured by all assets of the Corporation and its subsidiaries. The Credit Facility includes an accordion feature to increase the Credit Facility up to \$225 million subject to lenders' consent. As at September 30, 2013 and March 31, 2013, the Corporation used US\$22,000 on the Credit Facility.	\$ 22,667	\$ 22,352
Governmental authorities loans, repayable in variable annual instalments, with various expiry dates until fiscal year 2030.	34,811	36,101
Obligations under finance leases, all bearing fixed interest rates between 3.3% and 6.5% as at September 30, 2013 and March 31, 2013, maturing from January 2016 to July 2019, with amortization periods ranging from five to seven years, secured by the related property, plant and equipment, net of interest of \$404 (\$542 as at March 31, 2013).	4,675	5,420
Promissory note	—	402
Deferred financing costs, net	(1,098)	(1,318)
	<b>61,055</b>	<b>62,957</b>
Less: current portion	3,405	3,808
	<b>\$ 57,650</b>	<b>\$ 59,149</b>

**Note 13. Issued capital**

For the quarter and six-month period ended September 30, 2013, variations in common shares issued are as follows:

	Quarter ended September 30, 2013		Six months ended September 30, 2013	
	Number	Issued capital	Number	Issued capital
<b>Common shares issued and fully paid</b>				
Opening balance	31,520,782	\$ 25,432	31,511,446	\$ 25,365
Issued for cash on exercise of stock options	—	—	—	—
Issued for cash under the stock purchase and ownership incentive plan	8,771	66	18,107	133
<b>Closing balance</b>	<b>31,529,553</b>	<b>\$ 25,498</b>	<b>31,529,553</b>	<b>\$ 25,498</b>

## Issuance of common shares

During the quarter and six-month period ended September 30, 2013, the Corporation issued 8,771 and 18,107 common shares at a weighted-average price of \$7.55 and \$7.34 under the Corporation's stock purchase and ownership incentive plan for a total cash consideration of \$66 and \$133.

During the quarter and six-month period ended September 30, 2012, the Corporation issued 362,952 and 374,045 common shares respectively, at weighted-average prices of \$4.94 and \$5.02 for total cash considerations of \$1,794 and \$1,879. This includes 353,538 common shares which were issued (all in the second quarter), following the exercise of stock options for a total cash consideration of \$1,711. The initial fair value of these stock options, amounting to \$503 was transferred to the issued capital from the contributed surplus in the quarter ended September 30, 2012. The remainder of 9,414 and 20,507 common shares respectively were issued under the Corporation's stock purchase and ownership incentive plan for total cash considerations of \$83 and \$168.

### A. Stock option plan

During the quarters and six-month periods ended September 30, the number of stock options varied as follows:

	Quarter ended September 30, 2013		Quarter ended September 30, 2012	
	Weighted-average exercise price	Number of stock options	Weighted-average exercise price	Number of stock options
Balance at beginning of quarter	\$3.30	259,101	\$6.48	1,411,344
Granted	—	—	—	—
Exercised	—	—	4.84	(353,538)
Cancelled / forfeited	—	—	8.79	(111,900)
Balance at end of quarter	\$3.30	259,101	\$6.82	945,906

  

	Six months ended September 30, 2013		Six months ended September 30, 2012	
	Weighted-average exercise price	Number of stock options	Weighted-average exercise price	Number of stock options
Balance at beginning of period	\$3.30	259,101	\$6.48	1,411,344
Granted	—	—	—	—
Exercised	—	—	4.84	(353,538)
Cancelled / forfeited	—	—	8.79	(111,900)
Balance at end of period	\$3.30	259,101	\$6.82	945,906

For the quarter and six-month period ended September 30, 2013, the stock option expense amounted to \$27 and \$63 respectively (\$78 and \$193 in 2012).

### B. Stock purchase and ownership incentive plan

During the quarter and six-month period ended September 30, 2013, 8,771 and 18,107 common shares were issued respectively (9,414 and 20,507 respectively in 2012) and 3,595 and 7,429 common shares were attributed to the participating employees (3,827 and 8,404 respectively in 2012), under the stock purchase and ownership incentive plan. For the quarter and six-month period ended September 30, 2013, the expense related to the attributed common shares amounted to \$30 and \$61 respectively (\$38 and \$76 respectively in 2012).

### C. Stock appreciation right ("SAR") plan

During the quarter and six-month period ended September 30, 2013, 12,000 SARs were exercised (32,500 in 2012), no SARs were granted (none in 2012) and no SARs were cancelled (5,800 in 2012). As at September 30, 2013, on a cumulative basis, 27,000 SARs were still outstanding (92,200 in 2012) at a weighted-average granted value of \$1.68 (\$6.99 in 2012) which expire on various dates in fiscal 2015 and 2016.

For the quarter and six-month period ended September 30, 2013, SAR expense amounted to \$21 and \$42 respectively (\$634 and \$524 respectively in 2012).

In August 2010, the SAR plan has been replaced by the deferred share unit plan ("DSU") (see below).

### D. DSU plan

As at September 30, 2013, on a cumulative basis, 62,940 DSUs were outstanding (47,871 as at September 30, 2012).

During the quarter and six-month period ended September 30, 2013, no DSUs were issued (18,243 in the second quarter of 2012), no DSUs were cancelled (none in 2012), 12,362 DSUs were exercised, all in the second quarter (8,090 in the second quarter of 2012).

For the quarter and six-month period ended September 30, 2013, DSU expense amounted to \$59 and \$117 respectively (\$336 and \$322 respectively in 2012).

### Note 14. Accumulated other comprehensive income

Changes in accumulated other comprehensive income are as follows:

	Exchange differences on translation of foreign operations	Cash flow hedges	Hedge of net investments in U.S. operations	Total
<b>Balance as at June 30, 2013</b>	\$ 7,008	\$ (2,840)	\$ (1,317)	\$ 2,851
Other comprehensive income (loss) from continuing operations	(2,304)	2,105	411	212
<b>Balance as at September 30, 2013</b>	\$ 4,704	\$ (735)	\$ (906)	\$ 3,063
<b>Balance as at March 31, 2013</b>	\$ 3,215	\$ 63	\$ (631)	\$ 2,647
Other comprehensive income (loss) from continuing operations	1,489	(798)	(275)	416
<b>Balance as at September 30, 2013</b>	\$ 4,704	\$ (735)	\$ (906)	\$ 3,063

	Exchange differences on translation of foreign operations	Cash flow hedges	Hedge of net investments in U.S. operations	Total
<b>Balance as at June 30, 2012</b>	\$ 1,972	\$ 1,342	\$ (1,818)	\$ 1,496
Other comprehensive income (loss) from continuing operations	(1,601)	2,091	709	1,199
Other comprehensive income (loss) from discontinued operations (note 4)	(1,276)	1,153	1,105	982
<b>Balance as at September 30, 2012</b>	\$ (905)	\$ 4,586	\$ (4)	\$ 3,677
<b>Balance as at March 31, 2012</b>	\$ (771)	\$ 4,038	\$ (752)	\$ 2,515
Other comprehensive income (loss) from continuing operations	(894)	(442)	317	(1,019)
Other comprehensive income from discontinued operations (note 4)	760	990	431	2,181
<b>Balance as at September 30, 2012</b>	\$ (905)	\$ 4,586	\$ (4)	\$ 3,677

**Note 15. Net change in non-cash items related to continuing operations**

For the quarters and six-month periods ended September 30, the net change in non-cash items related to continuing operations is detailed as follows:

	Quarters ended September 30,		Six months ended September 30,	
	2013	2012	2013	2012
		(Restated - note 3)		(Restated - note 3)
Accounts receivable	\$ 3,090	\$ 2,548	\$ 9,705	\$ 5,350
Income tax receivable	(112)	—	121	—
Inventories	1,094	(128)	(434)	(3,571)
Other current assets	693	(744)	692	(684)
Accounts payable and accrued liabilities, accounts payable – other and, other liabilities	(3,605)	(3,128)	(9,613)	(1,900)
Provisions	(522)	294	(417)	180
Progress billings	(1,353)	(1,438)	(4,750)	(4,342)
Income tax payable	15	(770)	(776)	(2,920)
Effect of changes in exchange rate <sup>(1)</sup>	(396)	(1,236)	264	(748)
	\$ (1,096)	\$ (4,602)	\$ (5,208)	\$ (8,635)

<sup>(1)</sup> Reflects the total impact of changes in exchange rate during the related period on non-cash items listed above for the Corporation's U.S. subsidiaries.

**Note 16. Commitments**

The Corporation has released purchase orders relating to machinery and equipment which have not been delivered yet to the Corporation's facilities. As at September 30, 2013, these outstanding purchase orders amounted to \$1,784 (\$2,391 as at March 31, 2013) for which an amount of \$144 (\$234 as at March 31, 2013) in deposits on machinery and equipment were made and are included in the Corporation's other current assets.



## Note 17. Segment information

### Geographic information

Geographic information related to the continuing operations represents the following:

Quarters ended September 30,	2013			2012		
	Canada	U.S.	Total	Canada	U.S.	Total
Sales	\$ 48,401	\$ 8,001	\$ 56,402	\$ 45,543	\$ 12,141	\$ 57,684
Property, plant and equipment, net	66,436	11,994	78,430	65,834	12,445	78,279
Finite-life intangible assets, net	31,140	239	31,379	23,670	435	24,105
Goodwill	13,838	5,417	19,255	13,838	5,170	19,008
Export sales <sup>(1)</sup>	\$ 28,967			\$ 27,016		

During the quarters ended September 30, 2013 and 2012, 59% and 62% of the Corporation's sales respectively were made to U.S. customers.

Six months ended September 30,	2013			2012		
	Canada	U.S.	Total	Canada	U.S.	Total
Sales	\$ 98,923	\$ 20,451	\$ 119,374	\$ 97,124	\$ 24,340	\$ 121,464
Property, plant and equipment, net	66,436	11,994	78,430	65,834	12,445	78,279
Finite-life intangible assets, net	31,140	239	31,379	23,670	435	24,105
Goodwill	13,838	5,417	19,255	13,838	5,170	19,008
Export sales <sup>(1)</sup>	\$ 59,240			\$ 60,946		

During the six-month periods ended September 30, 2013 and 2012, 61% and 65% of the Corporation's sales respectively were made to U.S. customers.

<sup>(1)</sup>Export sales are attributed to countries based on customer location.



**MANAGEMENT DISCUSSION AND ANALYSIS OF  
FINANCIAL POSITION AND OPERATING RESULTS**

**For the quarter ended September 30, 2013**

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## Management Discussion and Analysis of Financial Position and Operating Results

The purpose of this management discussion and analysis ("MD&A") is to provide the reader with an overview of how the financial position of Héroux-Devtek Inc. and its subsidiaries ("Héroux-Devtek" or the "Corporation") evolved between March 31, 2013 and September 30, 2013. It also compares the operating results and cash flows for the quarter and six-month period ended September 30, 2013 to those for the same periods in the previous year.

This analysis should be read in conjunction with the Corporation's unaudited interim condensed consolidated financial statements for the quarter ended June 30, 2013 and six-month period ended September 30, 2013, and the audited consolidated financial statements and MD&A for the fiscal year ended March 31, 2013, all of which are available on the Corporation's website at [www.herouxdevtek.com](http://www.herouxdevtek.com). This MD&A is based on our unaudited interim condensed consolidated financial statements prepared in accordance with IAS 34, Interim Financial Reporting, using the Canadian dollar as the reporting currency. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

### Non-IFRS Measures

The Corporation uses earnings before interest, taxes, depreciation and amortization ("EBITDA") to assess its financial performance. EBITDA is a financial measure not prescribed by International Financial Reporting Standards ("IFRS"). However, the Corporation's management, as well as investors, consider this metric to be useful information to assist them in evaluating the Corporation's profitability, liquidity and ability to generate funds to finance its operations and capital investment needs.

The Corporation's EBITDA from continuing operations is calculated as follows, see Discontinued operations below:

(\$'000)	<u>Quarters ended</u> <u>September 30,</u>		<u>Six months ended</u> <u>September 30,</u>	
	2013	2012	2013	2012
Net income from continuing operations	2,584	2,645	5,398	5,591
Income tax expense (recovery)	(486)	167	488	1,130
Financial expenses	963	1,073	1,686	2,195
Amortization expense	3,193	3,104	6,429	6,344
<b>EBITDA</b>	<b>6,254</b>	<b>6,989</b>	<b>14,001</b>	<b>15,260</b>

For the quarter and six-month period ended September 30, 2013, the lower EBITDA reflects a lower operating income realized this quarter, when compared to last year, as explained in the following sections.

## **Forward-Looking Statements**

In the interest of providing shareholders and potential investors with information regarding Héroux-Devtek, including Management's assessment of future plans and operations, certain statements in this MD&A are forward-looking statements subject to risks, uncertainties and other important factors that could cause the Corporation's actual performance to differ materially from those expressed in or implied by such statements.

Such factors include, but are not limited to: the impact of worldwide general economic conditions and, in particular, economic conditions in Canada and the United States; industry conditions including changes in laws and regulations; increased competition; the lack of availability of qualified personnel or management; availability of commodities and fluctuations in commodity prices; foreign exchange or interest rate fluctuations; stock market volatility; and the impact of accounting policies issued by international standard setters. Some of these factors are further discussed under Risks and Uncertainties in this MD&A. Readers are cautioned that the foregoing list of factors that may affect future growth, results and performance is not exhaustive, and undue reliance should not be placed on forward-looking statements.

Although the Corporation believes that the expectations conveyed by the forward-looking statements are based on information available to it on the date such statements were made, there can be no assurance that such expectations will prove to be correct. All subsequent forward-looking statements, whether written or orally attributable to the Corporation or persons acting on its behalf, are expressly qualified in their entirety by these cautionary statements. Unless otherwise required by applicable securities laws, the Corporation expressly disclaims any intention, and assumes no obligation, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## **Overview**

Last year, on August 31, 2012, the Corporation concluded the sale of substantially all of its Aerostructure and Industrial product line operations ("sale transaction"), see Discontinued operations below. Following this transaction, Héroux-Devtek and its subsidiaries mainly specialize in the design, development, manufacture, repair and overhaul of landing gear systems and components used principally in the Aerospace market. The Corporation has also built a strong, well-recognized design engineering team.

The Corporation is the third largest landing gear company worldwide, supplying both the commercial and military sectors of the Aerospace market with new landing gear systems and components as well as aftermarket products and services (including spare parts and repair and overhaul services). In the commercial sector, the Corporation is active in the large commercial and business jet, regional aircraft and helicopter markets. On the military side, the Corporation provides parts and services for all major military aircraft, mainly in the United States. As such, a significant portion of the Corporation's sales are made to a limited number of customers mainly located in the United States and Canada.

The Corporation's head office is located in Longueuil, Québec with facilities in the Greater Montreal area (Longueuil, Laval and St-Hubert); Kitchener and Toronto, Ontario; as well as Springfield and Cleveland, Ohio. All facilities are involved in the fabrication of landing gear systems and components with the exception of the Toronto facility ("Magtron"), which manufactures electronic enclosures, heat exchangers and cabinets for airborne radar, electro-optic systems and aircraft controls. This facility provides competencies in vacuum and dips brazing metal joining technologies and became Canada's first facility to be Nadcap certified in aluminum vacuum brazing.

### **Discontinued Operations**

Last fiscal year, on July 16, 2012, the Corporation executed a definitive agreement for the sale of substantially all of its Aerostructure and Industrial product line operations to Precision Castparts Corporation ("PCC"), a public company trading on the New York Stock Exchange. The net assets acquired by PCC include the Corporation's Dorval (Quebec), Querétaro (Mexico) and Arlington (Texas) Aerostructure product line manufacturing sites, as well as the Cincinnati (Ohio) Industrial product line manufacturing sites.

The sale transaction was concluded on August 31, 2012 with gross sale proceeds, including post-closing adjustments, of \$297.8 million paid in cash. Taking into consideration the post-closing adjustments finalized during the last semester of fiscal year 2013, the net gain amounted to \$111.2 million.

Last year, concurrently to the sale transaction, the Corporation proceeded with a \$16 million reduction of finance lease obligations and the repayment of a \$1.0 million governmental authorities' loan related to the businesses sold. The Corporation also proceeded with a partial repayment of US\$37.5 million (\$37.0 million) against the Syndicated Banks' Credit Facility ("Credit Facility") and repurchased two of the three interest rate swap agreements in place, representing a total notional amount of US\$30 million, for a total cost of \$1.7 million which was recorded as transaction related costs to the sale transaction.

Following the sale transaction, the Board of Directors of the Corporation approved, on November 8, 2012, a special cash distribution of \$5.00 per share which was effectively paid on December 19, 2012 to shareholders of record on November 20, 2012. The special distribution to shareholders of \$5.00 per share which represented a cash distribution of \$157.5 million made on December 19, 2012, was composed of and recorded as an issued capital reduction of \$2.70 per share (\$85.0 million) and of a special cash dividend of \$2.30 per share (\$72.5 million) recorded against the retained earnings of the Corporation (see Liquidity and Capital Resources section below).



## RESULTS OF OPERATIONS

Following the sale transaction explained above, income and expenses from discontinued operations before August 31, 2012 are reported separately from income and expenses from continuing operations, down to the level of net income in the consolidated statements of income for all quarters of the last fiscal year ended March 31, 2013.

Prior to the sale transaction, the Aerostructure product line was part of the Corporation's Aerospace segment, while the Industrial product line formed the Industrial segment. Therefore, all of the operations of the businesses sold are excluded from the Corporation's segmented information. Following the sale transaction, the Corporation operates essentially in the Aerospace segment and is comprised of the Landing Gear product line and Magtron operations.

### Foreign Exchange

The Corporation is subject to foreign currency fluctuations from the translation of revenues (sales), expenses, assets and liabilities of its foreign operations and from transactions denominated mainly in US dollars. Transactions denominated in foreign currencies are initially recorded at the functional currency rate of exchange at the date of the transactions, but exclusive of forward foreign exchange contracts ("FFEC"), while the statement of income of foreign operations is translated at the average exchange rate for the period. FFEC, for the purpose of hedge accounting, are classified as cash flow hedges and transferred to the consolidated statements of income (sales) when the hedged transaction occurs, in accordance with the Corporation's accounting policies. The closing rates translate monetary assets and liabilities denominated in foreign currencies and assets and liabilities of foreign operations. The average exchange rates for the quarters and six-month periods ended September 30, 2013 and 2012, and the closing rates as at September 30, 2013 and March 31, 2013 were as follows (\$ Canadian / 1 US \$ equivalent):

<b>Canada / US Exchange Rates</b>	<b>September 30, 2013</b>	<b>September 30, 2012</b>
Average rate for quarters ended	1.0385	0.9948
Average rate for six months ended	1.0309	1.0025

  

<b>Canada / US Exchange Rates</b>	<b>September 30, 2013</b>	<b>March 31, 2013</b>
Closing rates	1.0303	1.0160

As shown above, the average value of the Canadian dollar for the quarter and six-month period ended September 30, 2013 was respectively 4.4% and 2.8% lower, when compared to its U.S. counterpart, year-over-year, and had a positive impact on the U.S.-denominated sales and results of the Corporation, exclusive of FFEC fluctuations, including those from its Canadian operations. The variation in the closing rate since March 31, 2013 had a favorable impact on the Corporation's U.S.-denominated balance sheet accounts at the end of this quarter, when compared to last year-end balances. Currency fluctuation impact on the Corporation's sales, gross profit and specific balance sheet elements can be found later in this MD&A.

The Corporation makes use of derivative financial instruments, in accordance with its hedging policy, to hedge foreign currency fluctuation exposure risks (Canadian dollar over US dollar) in an effort to mitigate these risks. As at September 30, 2013, the Corporation had FFEC to sell US\$115.1 million at a weighted-average rate of 1.0321 maturing at various dates between October 2013 and March 2017, with the majority maturing this and next fiscal year.

As at September 30, 2013, the Corporation had also entered into FFEC to sell US\$1.4 million at a weighted-average rate of 1.2275 all maturing this fiscal year, to cover foreign exchange risks (Canadian dollar over US dollar) related to certain embedded derivatives.

### Consolidated Sales

Consolidated sales for the second quarter ended September 30, 2013 decreased by \$1.3 million or 2.2% to \$56.4 million from \$57.7 million last year. This is the result of lower aftermarket military sales, partially offset by increased sales of \$2.2 million or 8.8% in the commercial sector, mainly resulting from higher sales on the B-777 program. Exchange fluctuations increased sales by \$0.4 million or 0.6%, when compared to last year.

At year-to-date, consolidated sales totaled \$119.4 million, 1.7% lower than last year's sales of \$121.5 million. The decrease in sales is also explained by lower aftermarket military sales, partially offset by increased sales of \$4.1 million or 8.1% in the commercial sector, mainly resulting from higher sales on the B-777 program. Exchange fluctuations increased sales by \$0.2 million or 0.2%, when compared to last year.

Sales can be broken down by sector as follows:

	<u>Quarters ended</u> <u>September 30,</u>				<u>Six months ended</u> <u>September 30,</u>			
	2013	2012	Variance		2013	2012	Variance	
	(\$'000)	(\$'000)	(\$'000)	%	(\$'000)	(\$'000)	(\$'000)	%
Military <sup>(1)</sup>	29,368	32,834	(3,466)	(10.6)	64,100	70,312	(6,212)	(8.8)
Commercial	27,034	24,850	2,184	8.8	55,274	51,152	4,122	8.1
<b>Total</b>	<b>56,402</b>	<b>57,684</b>	<b>(1,282)</b>	<b>(2.2)</b>	<b>119,374</b>	<b>121,464</b>	<b>(2,090)</b>	<b>(1.7)</b>

(1): Includes military sales to civil customers and governments.

Military sales were \$3.5 million or 10.6% lower this quarter to \$29.4 million and \$6.2 million or 8.8% lower at year-to-date to \$64.1 million. The decrease in sales is the result of lower customer demand on the B-2, Global Hawk, F-15 and C-17 programs, partially offset by new business with The Boeing Company ("Boeing") on the CH-47 helicopter program. At year-to-date, the decrease in military sales is also the result of lower repair and overhaul sales and lower electronic enclosure and cabinet sales at the Magtron operations, both resulting from lower customer requirements. The lower military sales reflect the weaker U.S. military market, as evidenced by the reduced funding of the U.S. base defense budget and the continued sequestration situation.

Commercial sales were \$2.2 million or 8.8% higher this quarter to \$27.0 million and \$4.1 million or 8.1% higher at year-to-date to \$55.3 million. This increase is the result of higher sales on large commercial programs, essentially resulting from new actuator business with Boeing on the B-777

program and production rate increases on the B-777 and A-320 programs, partially offset by lower aftermarket sales on the Bombardier CL-415 program.

### *Sales by Destination*

The Corporation's sales by destination were as follows:

	<u>Quarters ended</u> <u>September 30,</u>		<u>Six months ended</u> <u>September 30,</u>	
	<b>2013</b> <b>(%)</b>	<b>2012</b> <b>(%)</b>	<b>2013</b> <b>(%)</b>	<b>2012</b> <b>(%)</b>
Canada	35	33	34	30
US	59	62	61	65
International	6	5	5	5
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

This second quarter and year-to-date changes in the sales by destination mix mainly reflect the impact of increased large commercial sales delivered in Canada, combined with lower aftermarket military sales in the U.S.

### **Gross Profit**

This quarter, consolidated gross profit as a percentage of sales was 14.0%, an increase of 0.3% from 13.7% last year, while at year-to-date, it decreased by 0.8% to 14.3% from 15.1%.

The US/CAD currency fluctuations negatively impacted the Corporation's gross profit in dollars this quarter by \$0.2 million or 0.3%, when expressed as a percentage of sales, and at year-to-date by \$0.4 million or 0.3%, when expressed as a percentage of sales. Besides the natural hedging from the purchase of raw material in US dollars, the Corporation mitigates the currency impact by the use of FFEC.

This quarter and at year-to-date, consolidated gross profit was impacted by a higher under-absorption of manufacturing overhead costs, resulting from lower military customer requirements, combined with higher non-recurring costs incurred in the development of a new landing gear system program. These negative impacts on gross profit were partially offset by lower non-quality costs, when compared to last year. At year-to-date, consolidated gross profit was also impacted by an unfavorable military aftermarket sales product mix.

## Selling and Administrative Expenses

Selling and administrative expenses were as follows:

	<u>Quarters ended</u> <u>September 30,</u>		<u>Six months ended</u> <u>September 30,</u>	
	2013	2012	2013	2012
Selling and administrative expenses (\$'000)	<b>4,810</b>	3,997	<b>9,451</b>	9,463
% of sales	<b>8.5%</b>	6.9%	<b>7.9%</b>	7.8%

Selling and administrative expenses stood at \$4.8 million or 8.5% of sales for the quarter ended September 30, 2013, an increase of \$0.8 million or 1.6% of sales from \$4.0 million or 6.9% of sales last year. This quarter, the increase reflects higher research and development expenses of \$0.3 million, when compared to last year, for the development of new technologies and manufacturing improvements related to landing gear systems, which are not capitalized. It also reflects higher professional fees this year, compared to last year, including those related to the B-777 memorandum of agreement announced during the quarter. Selling and administrative expenses include a loss on currency translation on net monetary items denominated in foreign currencies of \$0.1 million, while last year, this currency translation represented a negligible loss.

For the six-month period ended September 30, 2013, selling and administrative expenses stood at \$9.5 million or 7.9% of sales this year, compared to \$9.5 million or 7.8% of sales last year. The gain on currency translation on net monetary assets amounted to \$0.4 million, compared to a negligible gain last year. This gain was offset by higher research and development expenses, when compared to last year, for the development of new technologies and manufacturing improvements related to landing gear systems, which are not capitalized.

## Operating Income

Consolidated operating income stood at \$3.1 million or 5.4% of sales for the quarter ended September 30, 2013, compared to \$3.9 million or 6.7% of sales last year. The lower operating income in dollars and as a percentage of sales mainly reflects higher selling and administrative expenses, as explained above.

For the six-month period ended September 30, 2013, consolidated operating income stood at \$7.6 million or 6.3% of sales, compared to \$8.9 million or 7.3% of sales last year. The lower operating income in dollars and as a percentage of sales is essentially the result of a lower gross profit, as explained above.

## Financial Expenses

Financial expenses stood at \$1.0 million and at \$1.7 million, respectively, for the quarter and six-month period ended September 30, 2013, compared to \$1.1 million and \$2.2 million, respectively, for the same periods last year.

This quarter, the lower financial expenses mainly resulted from lower discount rate adjustments of \$0.2 million recorded on the provision for asset retirement obligations. This was partially offset by lower interest income which resulted from a lower level of cash and cash equivalents, compared to last year, as last year's balance included the cash proceeds received from the sale transaction before the special cash distribution to shareholders amounting to \$157.5 million.

For the six-month period ended September 30, 2013, the lower financial expenses mainly resulted from a lower discount rate adjustment of \$0.3 million recorded on the provision for asset retirement obligations, reflecting the increase in the discount rate in the first semester of this year, while last year, it reflected a decrease in the discount rate for the comparable period.

### **Income Tax Expense**

For the quarters ended September 30, 2013 and 2012, the income tax expense (recovery) stood at \$(0.5) million and \$0.2 million respectively. At year-to-date, the income tax expense stood at \$0.5 million compared to \$1.1 million for the same period last year.

For the six-month period ended September 30, 2013, the Corporation's effective income tax rate was 8.3%, compared to its Canadian blended statutory income tax rate of 26.7%. The effective income tax rate reflects essentially a reduction in deferred income tax liabilities in light of changes in tax audit matters (\$0.9 million) and the favorable impact from permanent differences (\$0.2 million).

For the six-month period ended September 30, 2012, the Corporation's effective income tax rate was 16.8%, compared to its Canadian blended statutory income tax rate of 26.0%. The effective income tax rate reflects the favorable impact from permanent differences (\$0.3 million), partially offset by the negative impact of a higher U.S. income tax rate for the Corporation's U.S. subsidiaries (\$0.1 million). It also includes a reduction in deferred income tax liabilities in light of changes in tax audit matters (\$0.4 million).

The increase in the Corporation's blended statutory income tax rate this year, compared to last year, mainly reflects the difference in provincial income tax rates.

### **Net Income**

For the quarter and six-month period ended September 30, 2013, the Corporation posted a net income from continuing operations of \$2.6 million or 4.6% of sales and \$5.4 million or 4.5% of sales, respectively, compared to a net income from continuing operations of \$2.6 million or 4.6% of sales and \$5.6 million or 4.6% of sales for the same periods last year.

Last year's net income also included the net income from discontinued operations of \$110.0 million and \$113.3 million, respectively, for the quarter and six-month period ended September 30, 2012. Last year's net income from discontinued operations for the quarter and at year-to-date included a net gain of \$107.1 million from the sale transaction, excluding post-closing adjustments, as explained above (see Note 4 to the interim condensed consolidated financial statements).

	<u>Quarters ended</u>		<u>Six months ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net income from continuing operations (\$'000)	<b>2,584</b>	2,645	<b>5,398</b>	5,591
Net income from discontinued operations (\$'000)	—	110,000	—	113,258
Net income (\$'000)	<b>2,584</b>	112,645	<b>5,398</b>	118,849
Earnings per share from continuing operations – basic	<b>0.08</b>	0.09	<b>0.17</b>	0.18
Earnings per share from continuing operations – diluted	<b>0.08</b>	0.09	<b>0.17</b>	0.18
Earnings per share – basic (\$)	<b>0.08</b>	3.68	<b>0.17</b>	3.89
Earnings per share – diluted (\$)	<b>0.08</b>	3.64	<b>0.17</b>	3.86

Basic earnings per share figures are based on year-to-date weighted-averages of 31,521,584 common shares outstanding for the six-month period ended September 30, 2013 and 30,537,527 common shares for the same period last year, while the diluted earnings per share figures are based on year-to-date weighted-averages of 31,677,669 for the six-month period this year and 30,823,914 for the same period last year. The increase in the weighted-average number of outstanding common shares from September 30, 2012 to September 30, 2013 is mainly related to last fiscal year's issuance of 1,034,543 common shares under the Corporation's stock option plan.

On November 7, 2013, the date of this MD&A, the Corporation had 31,532,160 common shares and 259,101 stock options outstanding with a weighted-average of 3.3 years to maturity.

### **Accumulated Other Comprehensive Income (“AOCI”) and Comprehensive Income**

For the quarter and six-month period ended September 30, 2013, the other comprehensive income, included in the comprehensive income from continuing operations, is mainly the result of actuarial gains, net of change in asset limit and minimum funding requirements, on the Corporation's defined benefit pension plans, resulting from a higher interest rate to discount the defined benefit pension plan obligations, combined with the higher than expected return on plan assets.

### **Liquidity and Capital Resources**

#### *Special Distribution to Shareholders*

Last year, on November 8, 2012, following the sale transaction, the Board of Directors of the Corporation approved a special cash distribution of \$5.00 per share which was effectively paid on December 19, 2012 to shareholders of record on November 20, 2012. The Board of Directors determined that it was appropriate to proceed with this special distribution to the shareholders, following the sale transaction mentioned above, and that the Corporation would still maintain a healthy financial situation, post-special distribution, considering among other things, the expected capital and other investment requirements and results of the Corporation.



The special distribution to shareholders of \$5.00 per share which represented a cash distribution of \$157.5 million (based on 31,498,905 common shares outstanding on November 20, 2012) made on December 19, 2012 was composed of and recorded as an issued capital reduction of \$2.70 per share (\$85.0 million) and of a special cash dividend of \$2.30 per share (\$72.5 million) recorded against the retained earnings of the Corporation. The capital reduction which reduced the Corporation's issued capital, was approved by the shareholders at a special shareholder meeting held on December 18, 2012. The transaction costs related to this special distribution to shareholders amounting to \$0.3 million (\$0.2 million net of income taxes) were accounted for against the issued capital and retained earnings.

*Credit Facility and Cash and Cash Equivalents*

In general terms, the Corporation has a healthy financial situation and is well positioned to face its financing needs for the current fiscal year. Taking into account the sale transaction on August 31, 2012 and the special distribution to shareholders on December 19, 2012, the Corporation had cash and cash equivalents of \$92.7 million as at September 30, 2013, compared to \$101.3 million at March 31, 2013, of which \$5.0 million had been invested in short-term deposits (\$10.0 million at March 31, 2013). The remaining cash and cash equivalents were held in investment accounts with three Canadian Banks and their U.S. affiliates or branches of the Corporation's syndicated banks.

The Corporation has in place a Senior Secured Syndicated Revolving Credit Facility with a syndicate of five Canadian Banks and their U.S. affiliates or branches, and a Canadian branch of a U.S. Bank. This Credit Facility allows the Corporation and its subsidiaries to borrow up to \$150 million, either in Canadian or US currency equivalent and will mature in March 2016. It also includes an accordion feature to increase the Credit Facility up to \$225 million, during the term of the Credit Agreement, subject to approval by the lenders. As at September 30, 2013, the Corporation only had \$22.7 million (US\$22.0 million) drawn against the Credit Facility compared to \$22.4 million (US\$22.0 million) as at March 31, 2013. Considering the Corporation's cash and cash equivalents position, its available Credit Facility and level of expected capital investments and results, the Corporation's management does not expect any significant liquidity risk in the foreseeable future.

As at September 30, 2013, the Corporation had the following net cash position, calculated as follows:

	(\$'000)
Cash and cash equivalents	92,678
Less: Long-term debt, including current portion <sup>(1)</sup>	62,153
Net cash position	30,525

<sup>(1)</sup> *Excluding net deferred financing costs*

## Operating Activities

The Corporation generated cash flows from continuing operations and used cash and cash equivalents for its operating activities and its discontinued operations as follows:

	<u>Quarters ended</u> <u>September 30,</u>		<u>Six months ended</u> <u>September 30,</u>	
	2013 (\$'000)	2012 (\$'000)	2013 (\$'000)	2012 (\$'000)
Cash flows from continuing operations	4,685	6,009	11,837	12,998
Net change in non-cash items related to continuing operations	(1,096)	(4,602)	(5,208)	(8,635)
Cash flows related to operating activities from continuing operations	3,589	1,407	6,629	4,363
Cash flows related to operating activities from discontinued operations	—	(675)	(1,641)	8,273
Cash flows related to operating activities	3,589	732	4,988	12,636

The \$1.3 million decrease in cash flows from continuing operations for the quarter ended September 30, 2013, when compared to last year's period, is essentially explained by a \$1.1 million lower deferred income tax expense, partially offset by a \$0.2 million favorable discount rate adjustment.

For the six-month period ended September 30, 2013, the \$1.2 million decrease in cash flows from continuing operations, when compared to the same period last year, reflects essentially the favorable impact of discount rate adjustments of \$0.6 million, as already explained above, combined with a \$0.4 million lower deferred income tax expense and a \$0.2 million lower net income.

For the six-month period ended September 30, 2013, cash flows related to operating activities from discontinued operations includes the final payment of income taxes for the last fiscal year 2013.

The net change in non-cash items related to continuing operations can be summarized as follows:

	<u>Quarters ended</u> <u>September 30,</u>		<u>Six months ended</u> <u>September 30,</u>	
	2013 (\$'000)	2012 (\$'000)	2013 (\$'000)	2012 (\$'000)
Accounts receivable	3,090	2,548	9,705	5,350
Inventories	1,094	(128)	(434)	(3,571)
Accounts payable and accrued liabilities, accounts payable-other, and other liabilities (referred to as "accounts payable")	(3,605)	(3,128)	(9,613)	(1,900)
Progress billings	(1,353)	(1,438)	(4,750)	(4,342)
Income taxes payable and receivable	(97)	(770)	(655)	(2,920)
All others	(225)	(1,686)	539	(1,252)
	(1,096)	(4,602)	(5,208)	(8,635)

For the second quarter and six-month period ended September 30, 2013, the decrease in accounts receivable and accounts payable results from the lower sales volume this quarter, which is historically the lowest quarter of the year due to the vacation period and plant shut-downs. For the same periods, the reduction in progress billings reflects a reduced backlog on certain military programs. The reduction in income taxes payable and receivable for the six-month period ended September 30, 2013 mainly reflects the final payment of income taxes made for fiscal 2013.

For the second quarter and six-month period ended September 30, 2012, the decrease in accounts receivable and accounts payable results from a lower sales volume in the second quarter, which is traditionally the lowest quarter of the year, and a lower US/CAD foreign exchange closing rate for the accounts receivable and accounts payable denominated in US dollars. The reduction in progress billings mainly reflects a higher commercial funded backlog business mix, compared to military, and a reduced backlog on certain military programs. The increase in inventories, essentially from the first quarter, reflects the anticipated increase in production rates for the upcoming quarters in the commercial sector. The reduction in income tax payable for the six-month period ended September 30, 2012, mainly reflects the final payment of income taxes made in the first quarter for fiscal 2012.

### *Investing Activities*

The Corporation's investing activities were as follows:

	<u>Quarters ended</u>		<u>Six months ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>
Additions to property, plant and equipment <sup>(1)</sup>	<b>(3,340)</b>	(2,972)	<b>(6,521)</b>	(6,443)
Net decrease (increase) in finite-life intangible assets <sup>(1)</sup>	<b>(2,269)</b>	607	<b>(5,264)</b>	(2,501)
Proceeds on disposal of property, plant and equipment <sup>(1)</sup>	<b>47</b>	88	<b>47</b>	92
Net proceeds from sale of discontinued operations	—	272,796	—	272,796
Investing activities of discontinued operations	—	(2,919)	—	(4,294)
<b>Cash flows relating to investing activities</b>	<b>(5,562)</b>	<b>267,600</b>	<b>(11,738)</b>	<b>259,650</b>

<sup>(1)</sup> From continuing operations.

Additions to property, plant and equipment from continuing operations shown above can be reconciled as follows:

	<u>Quarters ended</u>		<u>Six months ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>
Additions to property, plant and equipment	<b>3,770</b>	4,012	<b>6,041</b>	6,207
Variation in unpaid additions included in Accounts payable - Other at period-end	<b>(430)</b>	(262)	<b>480</b>	1,014
Machinery and equipment acquired through finance leases	—	(778)	—	(778)
<b>Additions, as per statements of cash flows</b>	<b>3,340</b>	<b>2,972</b>	<b>6,521</b>	<b>6,443</b>

This quarter and at year-to-date, the additions to property, plant and equipment stood at \$3.8 million and \$6.0 million, respectively (\$4.0 million and \$6.2 million from continuing operations last year). It includes mainly capital investments in the St-Hubert Engineering and Longueuil operations facilities to support certain aerospace development programs, along with maintenance capital expenditure requirements.

Capital expenditures for fiscal 2014 are expected to be about \$16.0 million, including \$4.0 million related to the Landing Gear USA operations and \$2.0 million for the engineering facility.

The increase in finite-life intangible assets mainly represents capitalized development costs for long-term contracts, essentially for business jet design programs. Sales related to some of these programs are anticipated to begin this fiscal year and will gradually increase over the following years.

Last year's net proceeds from the sale of discontinued operations were related to the sale transaction and included the sale proceeds received in cash, excluding post-closing adjustments, net of the finance lease obligations reduction and transaction expenses paid.

#### *Financing Activities*

The Corporation's financing activities were as follows:

	<u>Quarters ended</u>		<u>Six months ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>
Repayment of long-term debt	<b>(486)</b>	(37,715)	<b>(3,047)</b>	(40,438)
Issuance of common shares	<b>66</b>	1,794	<b>133</b>	1,879
Financing activities of discontinued operations	—	(1,521)	—	(3,208)
<b>Cash flows relating to financing activities</b>	<b>(420)</b>	<b>(37,442)</b>	<b>(2,914)</b>	<b>(41,767)</b>

This year and last year's repayment of long-term debt includes the scheduled repayment of governmental authorities' loans, finance leases for machinery and equipment and a final payment on the promissory note. Last year's repayments also included the partial repayment of US\$37.5 million (\$37.0 million) against the Credit Facility, following the sale transaction.

During the quarter and six-month period ended September 30, 2013, the Corporation issued common shares under the Corporation's stock purchase and ownership incentive plan ("stock purchase plan"). For the same periods last year, the Corporation issued common shares following the exercise of stock options, and under its stock purchase plan (see below).

As at September 30, 2013, the Corporation was in compliance with all its restrictive debt covenants and expects to continue to comply with these restrictive financial covenants through the current fiscal 2014.

### **Capital Stock, Stock Option and Stock Purchase Plans**

As at September 30, 2013, the Corporation had 31,529,553 common shares outstanding (31,511,446 as at March 31, 2013).

During the quarter and six-month period ended September 30, 2013, the Corporation issued 8,771 and 18,107 common shares, respectively, under the Corporation's stock purchase plan, for total cash considerations of \$66,000 and \$133,000. For the same periods last year, the Corporation issued 353,538 common shares (all in the second quarter) following the exercise of stock options, for a total cash consideration of \$1,711,000, and 9,414 and 20,507 common shares, respectively, under its stock purchase plan, for total cash considerations of \$83,000 and \$168,000.

During the quarter and six-month period ended September 30, 2013, no stock options were granted (none in 2012), no stock options were exercised (353,538 in the second quarter of 2012), and no stock options were cancelled (111,900 last year, all in the second quarter).

As at September 30, 2013, 259,101 stock options were issued and outstanding with a weighted-average of 3.4 years to maturity and a weighted-average exercise price of \$3.30 (see Note 13 to the interim condensed consolidated financial statements).

For the quarter ended September 30, 2013, the stock option plan expense and the stock purchase plan expense amounted to \$27,000 and \$30,000, respectively (\$78,000 and \$38,000 in 2012) - see Note 13 to the interim condensed consolidated financial statements.

For the six-month period ended September 30, 2013, the stock option plan expense and the stock purchase plan expense amounted to \$63,000 and \$61,000, respectively (\$193,000 and \$76,000 in 2012) - see Note 13 to the interim condensed consolidated financial statements.

As at September 30, 2013, 1,750,381 common shares had not been issued yet under the Stock Option Plan and 256,114 common shares had not been issued yet under the Stock Purchase Plan.

## **Stock Appreciation Right (“SAR”) and Deferred Share Unit (“DSU”) Plans**

Until August 2010, the Corporation had a SAR plan where rights were issued to its non-employee directors. Although the SAR plan has since been replaced by a DSU plan effectively approved in May 2011 by the Corporation’s Board of Directors, outstanding SARs issued prior to August 2010 are still in effect.

As at September 30, 2013, on a cumulative basis, 27,000 SARs (92,200 last year) were still outstanding at a weighted-average granted price of \$1.68 (\$6.99 last year), which expire on various dates in fiscal 2015 and 2016. During the quarter and six-month period ended September 30, 2013, 12,000 SARs were exercised (32,500 in 2012), no SARs were granted (none in 2012) and no SARs were cancelled (5,800 in 2012).

As at September 30, 2013, on a cumulative basis, 62,940 DSUs were outstanding (47,871 last year). During the quarter and six-month period ended September 30, 2013, no DSUs were issued (18,243 in the second quarter last year), 12,362 DSUs were exercised (all in the second quarter) (8,090 in the second quarter last year).

For the quarter and six-month period ended September 30, 2013, SAR expense amounted to \$21,000 and \$42,000, respectively (expense of \$634,000 and \$524,000 in 2012) while DSU expense amounted to \$59,000 and \$117,000 (expense of \$336,000 and \$322,000 in 2012) - see Note 13 to the interim condensed consolidated financial statements.

## Consolidated Balance Sheets

The following table itemizes and explains the significant changes in the consolidated balance sheets between September 30, 2013 and March 31, 2013:

Item	March 31, 2013 (\$ million)	September 30, 2013 (\$ million)	Change (\$ million)	Explanation
Cash and cash equivalents	101.3	92.7	(8.6)	See consolidated statements of cash flows
Accounts receivable	46.6	36.8	(9.8)	Decrease resulting from a lower sales volume this quarter, compared to last year's fourth quarter. The second quarter is historically the lowest quarter of the year due to the vacation period and plant shut-downs. This decrease was partially offset by the impact of a higher US/CAD exchange rate used to convert the U.S.-denominated accounts receivable, when compared to March 31, 2013 (impact of \$0.4 million).
Derivative financial instruments (current and non-current assets)	3.2	0.9	(2.3)	Reflects the variation in the Corporation's balance sheets of derivative financial instruments measured at fair value. The decrease is mainly the result of a lower differential between the weighted-average US/CAD rates of forward foreign exchange contracts on hand and the closing rate of conversion used, as of both balance sheet dates.
Finite-life intangible assets, net	26.5	31.4	4.9	Reflects the increase in capitalized development costs for long-term contracts (\$5.1 million) and in software costs (\$0.2 million), net of software amortization expense (\$0.4 million).
Accounts payable and accrued liabilities	44.3	37.6	(6.7)	Decrease mainly resulting from a lower sales volume this quarter, compared to last year's fourth quarter sales. This decrease was partially offset by the impact of a higher US/CAD exchange rate used to convert U.S.-denominated accounts payable and accrued liabilities, when compared to March 31, 2013 (impact of \$0.2 million).
Accounts payable - other	2.4	1.6	(0.8)	Decrease mainly reflecting the lower unpaid portion of property, plant and equipment additions.
Progress billings (current and long-term)	12.3	7.5	(4.8)	The reduction in progress billings mainly reflects a reduced backlog on certain military programs.
Income tax payable	2.5	0.1	(2.4)	Decrease mainly reflecting the final income tax payments made this year related to the balance due from the last fiscal year.

Item	March 31, 2013 (\$ million)	September 30, 2013 (\$ million)	Change (\$ million)	Explanation
Derivative financial instruments (current and long-term liabilities)	2.6	1.8	(0.8)	Reflects the variation in the Corporation's balance sheets of derivative financial instruments measured at fair value. The decrease is mainly the result of a lower differential between the closing rate of conversion used and the weighted-average US/CAD rates of forward foreign exchange contracts on hand, as of both balance sheet dates.
Long-term debt (including current portion)	63.0	61.1	(1.9)	The decrease reflects the scheduled repayment of long-term debt (\$3.0 million) net of interest accretion on increased governmental authorities' loans (\$0.9 million) and amortization of deferred financing costs related to the Credit Facility (\$0.2 million).
Other liabilities – Pension and other retirement benefit plans	13.0	7.6	(5.4)	Decrease resulting from actuarial gains, net of change in asset limit and minimum funding requirements, on the Corporation's defined benefit pension plans (as already explained above), combined with scheduled payments made in the six-month period ended September 30, 2013.
Retained earnings	193.4	201.5	8.1	The increase reflects the Corporation's net income of \$5.4 million for the six-month period ended September 30, 2013, combined with the defined benefit actuarial net gains of \$3.1 million and net change in asset limit and minimum funding requirements amounting to \$0.4 million on the Corporation's defined benefit pension plans for the same period.

As at September 30, 2013 and March 31, 2013, the Corporation's working capital ratio, cash and cash equivalents, long-term debt-to-equity ratio and net cash-to-equity ratio<sup>(1)</sup> were as follows:

	September 30, 2013	March 31, 2013
Working capital ratio	<b>4.16:1</b>	3.59:1
Cash and cash equivalents	<b>\$92.7 million</b>	\$101.3 million
Long-term debt-to-equity ratio	<b>0.25:1</b>	0.27:1
Net cash-to-equity ratio <sup>(1)</sup>	<b>0.14:1</b>	0.17:1

(1): Defined as cash and cash equivalents less total long-term debt, including the current portion over shareholders' equity.



## **Government Assistance**

During the quarter ended September 30, 2013, the Corporation recorded as government assistance for continuing operations an amount of \$1.1 million as a reduction of incurred cost of sales and selling and administrative expenses (\$0.6 million for the quarter ended September 30, 2012) and an amount of \$1.2 million (\$0.9 million for the quarter ended September 30, 2012) as a reduction of the related capital expenditures or capitalized development costs, presented under Finite-life intangible assets.

During the six-month period ended September 30, 2013, the Corporation recorded as governmental assistance for continuing operations an amount of \$1.5 million as a reduction of incurred cost of sales and selling and administrative expenses (\$1.1 million last year) and an amount of \$1.5 million (\$1.3 million last year) as a reduction of the related capital expenditures or capitalized development costs, presented under Finite-life intangible assets.

This government assistance includes mainly the investment tax and other credits, grants and the discounted portion of the governmental authorities loans.

## **Derivatives, Off-Balance-Sheet Items and Commitments**

As at September 30, 2013, the Corporation had operating lease obligations amounting to \$1.0 million for buildings and facilities. These amounts are repayable over the next five fiscal years. The Corporation also had machinery and equipment purchase commitments totaling \$1.8 million (see Note 16 to the interim condensed consolidated financial statements).

As at September 30, 2013, the Corporation had forward foreign exchange contracts ("FFEC") with Canadian chartered banks to sell US\$115.1 million at a weighted-average exchange rate (Canadian dollar over US dollar) of 1.0321. These contracts relate mainly to its export sales, and mature at various dates between October 2013 and March 2017, but mainly this and next fiscal year (see Note 10 to the interim condensed consolidated financial statements). This compares to US\$123.5 million and US\$136.3 million in FFEC held at March 31, 2013 and September 30, 2012, respectively, at weighted-average exchange rates of 1.0325 and 1.0498, respectively. The lower FFEC, compared to last year-end and last year's period, reflects the changes in the funded backlog.

As at September 30, 2013 and March 31, 2013, the Corporation had also entered into FFEC contracts to sell US\$1.4 million at a weighted-average rate of 1.2275 (Canadian dollar over US dollar) and US\$4.7 million at a weighted-average rate of 1.2262 (Canadian dollar over US dollar), respectively. These contracts cover foreign exchange risk related to certain embedded derivative financial instruments and they all mature this fiscal year.

The credit and credit concentration risks related to these financial instruments are limited due to the fact that the Corporation deals exclusively with Canadian chartered banks and their U.S. subsidiaries or branches, which are high-grade financial institutions, based on the Corporation's investment policy. On that basis, the Corporation does not anticipate any breach of agreement by counterparties.

In March 2011, the Corporation designated certain long-term debt as hedge of its net investments in U.S. operations. This designation was still in effect as at September 30, 2013.

## **Financial and Economic Situation**

Improvements in the global economy continue to have a positive effect on most of the Corporation's markets related to commercial aerospace. In the large commercial aircraft market, Boeing and Airbus are proceeding with production rate increases for certain leading programs and backlogs remain strong, representing 7 to 8 years of production at current rates. Business jet shipments declined slightly in the first six months of calendar 2013, but key indicators point to a recovery, such as increased aircraft utilization and a reduction in the number of used aircraft for sale, as a percentage of the fleet.

However, the military aerospace market remains weak as governments address their deficits. In the United States, the Corporation's largest military market, uncertainty surrounding the duration of sequestration, including related defense cutbacks, could affect the Corporation beyond the current fiscal year.

The global economy remains fragile because of the debt situation of several countries and geopolitical instability in certain regions. Consequently, Héroux-Devtek continues to carefully monitor its strategy and risk management.

While the Corporation's backlog remains healthy, deferrals or cancellations of purchase orders could have an adverse impact on future results. The Corporation is striving to maintain a well-balanced portfolio between commercial and military sector sales, as well as between new component manufacturing and aftermarket products and services. This balance should help reduce the risks associated with any potential slowdown in specific markets.

Furthermore, the rapid fluctuations in the value of the Canadian dollar, when compared to the US currency, may put additional pressure on upcoming results. As already mentioned, and as highlighted in the Outlook section, Management maintains its focus on operational efficiencies through continued lean manufacturing initiatives, cost reduction initiatives and FFEC to remain competitive on a global basis.

From a financial standpoint, the Corporation has a healthy balance sheet and is presently in compliance with all of its financial covenants and expects to be so through the next fiscal year. The Corporation does not expect to have any liquidity issues, considering that the Banks' Credit Facility was extended with a syndicate of five Canadian banks and a Canadian branch of a U.S. bank, with high-grade credit ratings, and that the major customers of the Corporation are government or worldwide leaders in their respective fields. This Credit Facility was renewed and increased in fiscal 2011 and will mature in March 2016.

In light of the above, the Corporation maintains its near-term outlook (see Outlook section below) and does not foresee any significant short-term event that could jeopardize the going concern of its operations. That being said, and understanding that the Corporation operates, in part, in sectors subject to economic volatility, Management remains prudent (see Risks and Uncertainties and Outlook sections below).

## CHANGES IN ACCOUNTING POLICIES

On April 1<sup>st</sup>, 2013, the Corporation adopted retrospectively the standards below in accordance with required changes from the International Accounting Standard Board. The adoption of these new standards did not have a material impact on prior periods comparative figures.

### ***IAS 1 Financial Statement Presentation***

The amended IAS 1, Presentation of Financial Statements was adopted retrospectively effective April 1<sup>st</sup>, 2013. The principal change resulting from the amendments to IAS 1 is the requirement to present separately other comprehensive income items that may be reclassified to income from other comprehensive items that will not be reclassified to income in the consolidated statement of comprehensive income.

### ***IFRS 13 Fair Value Measurements***

The IFRS 13, Fair Value Measurements was adopted retrospectively effective April 1<sup>st</sup>, 2013, and is a new and comprehensive standard that sets out a framework for measuring at fair value and that provides guidance on required disclosures about fair value measurements.

### ***IAS 19 Employee Benefits***

The amended IAS 19, Employee Benefits was adopted retrospectively effective April 1<sup>st</sup>, 2013. Amongst other changes, the amendments require entities to compute the financing cost component of defined benefit plans by applying the discount rate used to measure post-employment benefit obligations to the net post-employment benefit obligations (usually, the present value of defined benefit obligations less the fair value of plan assets). Also, the net interest cost is now presented in the financial expenses. Furthermore, the amendments to IAS 19 enhance the disclosure requirements for defined benefit plans, providing additional information about the characteristics of defined benefit plans and the risks that entities are exposed to, through participation in those plans. The changes in accounting policy have been accounted for retrospectively in accordance with the transition rules of the amended IAS 19 and the additional required disclosures will be provided in our annual consolidated financial statements for fiscal year 2014.

The impact of the adoption of the amended IAS 19, Employee Benefits on the consolidated statement of income and consolidated statement of comprehensive income for the quarter and six-month period ended September 30, 2012 are as follows:

	<b>Quarter ended</b>	<b>Six months ended</b>
<b>(\$'000)</b>		
• Decrease of cost of sales	(17)	(35)
• Increase of financial expenses	126	252
• Decrease of income tax expense	(30)	(59)
• Decrease of net income from continuing operations and net income	(79)	(158)
• Decrease of actuarial losses, net of income taxes	(79)	(158)
• Increase of other comprehensive income from continuing operations and other comprehensive income	79	158

## **INTERNAL CONTROLS AND PROCEDURES**

The purpose of internal controls over financial reporting is to provide reasonable assurance as to the reliability of the Corporation's financial reporting and the preparation of its financial statements in accordance with International Financial Reporting Standards.

No changes were made to the Corporation's internal controls over financial reporting during the quarter and six-month period ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **RISKS AND UNCERTAINTIES**

Héroux-Devtek operates in industry segments with a variety of risk factors and uncertainties that could have a material adverse effect on the Corporation's business, financial condition and results of operations. Such risks and uncertainties include, but are not limited to, those mentioned below.

- Reliance on Large Customers
- Availability and Cost of Raw Materials
- Operational Risks
- Impact of Terrorist Activity and Political Instability
- General Economic Conditions
- Military Spending
- Foreign Currency Fluctuations
- Liquidity and Access to Capital Resources
- Restrictive Debt Covenants
- Changing Interest Rates
- External Business Environment
- Warranty Casualty Claim Losses
- Environmental Matters
- Collective Bargaining Agreements\*
- Skilled Labour
- Pension Plan Liability

\* Landing Gear - Longueuil collective agreement is expiring on May 1, 2014.

## SELECTED QUARTERLY FINANCIAL INFORMATION

(\$'000 Except per share data)	Fiscal Year 2014		Fiscal Year 2013				Fiscal Year 2012	
	Sept. 30, 2013	June 30, 2013	March 31, 2013	Dec. 31, 2012	Sept. 30, 2012	June 30, 2012	March 31, 2012	Dec. 31, 2011
Average exchange rate used to translate revenues (sales) and expenses <sup>(1)</sup> (\$Canadian / 1 equivalent \$US)	<b>1.0385</b>	<b>1.0233</b>	1.0089	0.9913	0.9948	1.0102	1.0012	1.0231
Sales from continuing operations	<b>56,402</b>	<b>62,972</b>	73,816	61,742	57,684	63,780	74,777	61,988
EBITDA from continuing operations <sup>(2)</sup>	<b>6,254</b>	<b>7,747</b>	10,159	7,672	6,989	8,271	11,473	10,302
Net income from continuing operations <sup>(2)</sup>	<b>2,584</b>	<b>2,814</b>	4,695	3,216	2,645	2,946	5,558	4,463
Net income from discontinued operations	—	—	3,679	1,289	110,000	3,258	3,360	2,403
Net income <sup>(2)</sup>	<b>2,584</b>	<b>2,814</b>	8,374	4,505	112,645	6,204	8,918	6,866
Earnings per share from continuing operations (\$) – Basic <sup>(2)</sup>	<b>0.08</b>	<b>0.09</b>	0.15	0.10	0.09	0.10	0.18	0.15
Earnings per share from continuing operations (\$) – Diluted <sup>(2)</sup>	<b>0.08</b>	<b>0.09</b>	0.15	0.10	0.09	0.10	0.18	0.15
Earnings per share (\$) – basic <sup>(2)</sup>	<b>0.08</b>	<b>0.09</b>	0.27	0.14	3.68	0.20	0.29	0.23
Earnings per share (\$) – diluted <sup>(2)</sup>	<b>0.08</b>	<b>0.09</b>	0.26	0.14	3.64	0.20	0.29	0.22
Weighted-average number of diluted shares outstanding (in millions)	<b>31.7</b>	<b>31.7</b>	31.7	31.3	31.0	30.8	30.8	30.7

<sup>(1)</sup> Exclusive of forward foreign exchange contracts.

<sup>(2)</sup> Restated, see note 3 to the interim condensed consolidated financial statements.

## OUTLOOK

Conditions remain mostly favorable in the commercial aerospace market. As at the end of August 2013, the passenger market, expressed in revenue-passenger-kilometers, has grown by 5.1%, while the cargo market, measured in freight-tonne-kilometers, rose 0.7%. The IATA's most recent forecast calls for a 5.0% growth in the passenger market for calendar 2013, followed by a 5.8% growth in calendar 2014. Meanwhile, air cargo volume is expected to slightly rise 0.9% in calendar 2013, with growth accelerating to 3.7% in calendar 2014.<sup>1</sup>

<sup>1</sup> Sources: IATA press releases October 1, 2013; October 2, 2013; IATA Industry Financial Forecast September 2013.

In the large commercial aircraft segment, Boeing and Airbus continue to proceed with production rate increases on several leading programs scheduled for calendar years 2013 and 2014, although production of the B-747 will decrease in calendar 2014.<sup>2</sup> Reflecting these greater production rates, both manufacturers are forecasting higher deliveries in calendar 2013 than a year earlier. Their backlogs remain strong, representing 7 to 8 years of production at current rates.

In the business jet market, year-over-year deliveries declined slightly in the first six months of calendar 2013, but key indicators point to a recovery, such as increased aircraft utilization and a reduction in the number of used aircraft for sale, as a percentage of the fleet. More importantly, industry sources are calling for sustained growth over up to possibly five years, a period spanning the planned entry into service of several business jet models for which Héroux-Devtek has designed the landing gear.<sup>3</sup>

Conditions in the military aerospace market remain difficult as governments address their deficits. In the U.S., given the uncertainty surrounding the duration of sequestration, the Corporation may continue to be affected by U.S. defense cutbacks beyond the current fiscal year, despite having a diversified military portfolio, balanced between new component manufacturing and aftermarket products and services, that should lessen this impact.

The Corporation's balance sheet remains healthy with cash and cash equivalents of \$92.7 million as at September 30, 2013. This amount, combined with funds available under its Credit Facility, will allow Héroux-Devtek to fund expected capital expenditures of approximately \$16 million in fiscal 2014 as well as to consider other strategic acquisitions that would complement its product portfolio and its technologies.

As at September 30, 2013, Héroux-Devtek's funded (firm orders) backlog stood at \$347 million, versus \$361 million at the beginning of the fiscal year, mainly reflecting lower backlog on certain military programs. Despite this solid backlog and strong customer relationships, the Corporation will continue to enhance productivity and streamline its cost base to remain competitive in light of the increasingly global character of the aerospace industry.

In the short-term, the joint effect of U.S. military spending restrictions, the persistent sequestration and the government shutdown in October, will further impact consolidated sales for the fiscal year ending March 31, 2014, which are now expected to be slightly lower than last year, offsetting robust commercial aerospace activity that should yield sales growth of approximately 10% in this market. Given the weak military market, we must proactively optimize our asset utilization and adapt supply to demand, as evidenced by the recent workforce reduction.

The scenario for the remainder of fiscal 2014 assumes the Canadian dollar remains at parity versus the US currency and considers the Corporation's FFEC. Over the long-term, Héroux-Devtek remains committed to its stated goal of growing, internally and through strategic alliances, including business acquisitions, at 10% per year, on average, assuming a stable currency environment.

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<sup>2</sup> Sources: Airbus press release April 4, 2013. Boeing press releases October 31, 2013; October 23, 2013; October 18, 2013; April 19, 2013; March 18, 2013; November 12, 2012; October 23, 2012.

<sup>3</sup> Sources: GAMA, JETNET, FAA, Teal Group, Forecast International.

## **Additional Information and Continuous Disclosure**

This MD&A was approved by the Audit Committee and by the Board of Directors on November 7, 2013. Updated information on the Corporation can be found on the SEDAR website, at [www.sedar.com](http://www.sedar.com).