



**HÉROUX DEVTEK** 

# Growing together

Quarterly report

SECOND QUARTER ENDED  
SEPTEMBER 30, 2007

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# Message to Shareholders

**On behalf of the Board of Directors, I am pleased to present the financial results for Héroux-Devtek's second quarter ended September 30, 2007.**

We had a solid quarter in all of our operations and we are pleased with sound revenue growth and further profitability improvements in both our Aerospace and Industrial segments. Héroux-Devtek continues to benefit from robust business activity in all of its markets, including the power generation market, despite the normal seasonal slowdown associated with plant shutdowns and summer vacation. In addition, benefits from initiatives undertaken in previous years to streamline and improve our operations played an important role in enhancing profit margins.

The Landing Gear Division further benefited from buoyant market conditions in large commercial aircraft and business jets but was somewhat negatively impacted by lower military repair and overhaul sales. Our Aerostructure Division had another strong quarter led by greater shipments for the Joint Strike Fighter (JSF) and F-16 programs and, to a lesser degree, from the schedule recovery of orders for a commercial aircraft program. Finally, the positive trend in gas turbine sales that started in the second quarter of fiscal 2007 continued in the quarter ended September 30, 2007.

Overall, sales for our second quarter amounted to \$69.8 million, an increase of 11.3% over sales of \$62.7 million reported in the same quarter last year. Landing Gear sales grew by 6.5% to \$41.1 million, while Aerostructure sales were up 22.8% compared with the same period a year prior, to reach \$20.5 million. Sales from our Industrial segment reached \$7.7 million, up 18.9% over last year due to the improvement in the gas turbine market. However, the strong Canadian dollar reduced total sales by \$3.4 million or 5.4% compared with the same period last year.

Gross profit was favourably impacted by higher sales volume and improved margins on certain contracts at the Aerostructure division and by the continued turnaround at the Gas Turbine division. These were

partially offset by reduced military repair and overhaul sales at the Landing Gear division. The stronger Canadian dollar had a 0.9% negative impact on the consolidated gross profit margin in the quarter ended September 30, 2007, compared with the same period last year. The Company uses forward foreign exchange contracts to mitigate the risks related to the Canadian currency fluctuations towards the US currency.

Second quarter operating income reached \$5.2 million, or 7.5% of sales, compared with \$2.3 million, or 3.7% of sales last year, with noticeable improvements in both the Aerospace and Industrial segments. Consequently, net income increased to \$3.1 million or \$0.10 per share, fully diluted, compared with \$1.5 million or \$0.05 per share, fully diluted, for the same period last year.

For the first six months of the current fiscal year, sales increased by 15.2% to reach \$148.5 million, versus \$129.0 million last year. Consolidated gross profit, as a percentage of sales, also improved year-to-date from 9.3% last year to 13.5% this year. Besides the factors already mentioned before, the development phase of the JSF program, which trimmed the Aerostructure division gross profit in the first quarter this year was not as significant to the division margins in the second quarter this year. Operating income of \$11.6 million, or 7.8% of sales, compares favourably with \$3.8 million, or 3.0% of sales, a year earlier. Year-to-date, net income amounted to \$7.3 million, or \$0.23 per share, fully diluted, versus \$2.2 million, or \$0.07 per share, fully diluted, a year ago.

During the quarter, our Landing Gear division was awarded contracts totaling \$14.5 million to supply landing gear components mainly for the C-130, C-5, F-16, KC-135, E3 and B-1B aircraft, essentially from the United States Air Force. These new orders are in addition to similar contracts announced in October 2006. Production will be spread out over the next four years, with deliveries expected to start in fiscal year 2009.

The order books of large commercial aircraft manufacturers continue to be very strong, a situation conducive to further business opportunities for suppliers such as Héroux-Devtek. The military aerospace market also remains solid. Meanwhile, the power generation industry continues to improve, which should help restore operating profitability in the Industrial segment.

Given our solid backlog, we continue to expect achieving approximately 10% internal sales growth in fiscal 2008. In light of the continued strength of the Canadian dollar toward the US currency, we must continue to improve or make productivity gains to maintain our competitiveness. Our significant capital expenditure investment plan to support the expected internal sales growth along with our additional training programs for employees will both contribute to improvements in productivity.

(signed)

Gilles Labbé

President and Chief Executive Officer

October 31, 2007

## NOTICE OF DISCLOSURE OF NON-AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS FOR THE QUARTERS ENDED SEPTEMBER 30, 2007 AND 2006.

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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 interim financial statements, the interim financial statements must be accompanied by a notice indicating that they have not been reviewed by the external auditors.

The accompanying unaudited interim consolidated financial statements of the Company for the quarters ended September 30, 2007 and 2006, have been prepared in accordance with Canadian generally accepted accounting principles and are the responsibility of the Company's management.

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

Dated this 31<sup>st</sup> day of October 2007.

## CONSOLIDATED BALANCE SHEETS

As at September 30, 2007 and March 31, 2007

(In thousands of dollars) (Unaudited)

	Notes	September 2007	March 2007
<b>Assets</b>	<b>4</b>		
<b>Current assets</b>			
Cash and cash equivalents		\$ 4,238	\$ 20,124
Accounts receivable		40,021	46,850
Income tax receivable		4,409	2,523
Other receivables		6,250	4,665
Inventories		89,689	92,728
Prepaid expenses		1,239	974
Future income taxes		6,854	8,226
Other current assets	2	13,473	2,041
		<b>166,173</b>	<b>178,131</b>
<b>Property, plant and equipment, net</b>	2	<b>110,656</b>	<b>109,682</b>
<b>Finite-life intangible assets, net</b>		<b>5,909</b>	<b>7,722</b>
<b>Other assets</b>	2	<b>7,737</b>	<b>51</b>
<b>Future income taxes</b>		<b>259</b>	<b>-</b>
<b>Goodwill</b>		<b>35,248</b>	<b>38,093</b>
		<b>\$ 325,982</b>	<b>\$ 333,679</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	2	\$ 65,620	\$ 82,615
Income tax payable		569	-
Future income taxes	2	6,294	2,542
Current portion of long-term debt	2,4	4,182	6,691
		<b>76,665</b>	<b>91,848</b>
<b>Long-term debt</b>	2,4	<b>55,660</b>	<b>66,262</b>
<b>Other liabilities</b>	2	<b>6,783</b>	<b>6,462</b>
<b>Future income taxes</b>	2	<b>11,555</b>	<b>8,259</b>
		<b>150,663</b>	<b>172,831</b>
<b>Shareholders' equity</b>			
Capital stock	5	104,149	103,620
Contributed surplus	5	872	691
Accumulated other comprehensive loss	2	(3,276)	(8,034)
Retained earnings	2	73,574	64,571
		<b>175,319</b>	<b>160,848</b>
		<b>\$ 325,982</b>	<b>\$ 333,679</b>

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

## CONSOLIDATED STATEMENTS OF INCOME

For the periods ended September 30, 2007 and 2006

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

	Notes	Quarters ended September 30		Six months ended September 30	
		2007	2006	2007	2006
Sales		\$ 69,758	\$ 62,669	\$ 148,534	\$ 128,986
Cost of sales		56,257	51,871	120,178	108,604
Amortization	2	4,072	4,226	8,307	8,367
Gross profit		9,429	6,572	20,049	12,015
Selling and administrative expenses		4,229	4,259	8,469	8,177
Operating income		5,200	2,313	11,580	3,838
Financial expenses, net	2, 4	1,506	880	2,752	1,754
Income before income tax expense (recovery)		3,694	1,433	8,828	2,084
Income tax expense (recovery)	2	587	(63)	1,570	(100)
Net income		\$ 3,107	\$ 1,496	\$ 7,258	\$ 2,184
Earnings per share – basic and diluted		\$ 0.10	\$ 0.05	\$ 0.23	\$ 0.07
Weighted-average number of shares outstanding during the periods		31,622,268	31,509,778	31,587,133	31,501,315

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

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the periods ended September 30, 2007 and 2006

(In thousands of dollars) (Unaudited)

For the quarter ended September 30, 2007

	Notes	Capital Stock	Contributed surplus	Accumulated other comprehensive income (loss)	Cumulative translation adjustment	Retained earnings	Comprehensive income (loss)
<b>Balance at June 30, 2007</b>		\$ 104,093	\$ 769	\$ (1,768)	\$ -	\$ 70,467	\$ -
Common shares issued:							
Under the stock option plan	5	-	-	-	-	-	-
Under the stock purchase and ownership plan		56	-	-	-	-	-
Stock-based compensation	5	-	103	-	-	-	-
Net income		-	-	-	-	3,107	3,107
Net gains on derivative financial instruments designated as cash flow hedges, net of taxes of \$1,840		-	-	3,928	-	-	3,928
Net gains on derivative financial instruments designated as cash flow hedges in prior periods transferred to net income in the current period, net of taxes of \$898		-	-	(1,866)	-	-	(1,866)
Cumulative translation adjustment		-	-	(3,570)	-	-	(3,570)
<b>Balance at September 30, 2007</b>		<b>\$104,149</b>	<b>\$ 872</b>	<b>\$ (3,276)</b>	<b>\$ -</b>	<b>73,574</b>	<b>\$ 1,599</b>

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (cont'd)

For the six-month period ended September 30, 2007

	Notes	Capital Stock	Contributed surplus	Accumulated other comprehensive income (loss)	Cumulative translation adjustment	Retained earnings	Comprehensive income (loss)
<b>Balance at March 31, 2007,</b>							
<b>as previously reported</b>		\$ 103,620	\$ 691	\$ -	\$ (8,034)	\$ 64,571	\$ -
Change in accounting policies:	2						
Loans bearing no interest		-	-	-	-	1,745	-
Cumulative translation adjustment		-	-	(8,034)	8,034	-	-
Accumulated gains on derivative financial instruments designated as cash flow hedges, net of taxes of \$2,753		-	-	5,597	-	-	-
<b>Balance at March 31, 2007, adjusted</b>		<b>103,620</b>	<b>691</b>	<b>(2,437)</b>	<b>-</b>	<b>66,316</b>	<b>-</b>
Common shares issued:	5						
Under the stock option plan		413	-	-	-	-	-
Under the stock purchase and ownership plan		116	-	-	-	-	-
Stock-based compensation expense	5	-	181	-	-	-	-
Net income		-	-	-	-	7,258	7,258
Net gains on derivative financial instruments designated as cash flow hedges, net of taxes of \$4,762		-	-	9,971	-	-	9,971
Net gains on derivative financial instruments designated as cash flow hedges in prior periods transferred to net income in the current period, net of taxes of \$1,334		-	-	(2,772)	-	-	(2,772)
Cumulative translation adjustment		-	-	(8,038)	-	-	(8,038)
<b>Balance at September 30, 2007</b>		<b>\$104,149</b>	<b>\$ 872</b>	<b>\$ (3,276)</b>	<b>\$ -</b>	<b>\$ 73,574</b>	<b>\$ 6,419</b>

For the quarter ended September 30, 2006

	Notes	Capital Stock	Contributed surplus	Accumulated other comprehensive income (loss)	Cumulative translation adjustment	Retained earnings	Comprehensive income (loss)
<b>Balance at June 30, 2006, as</b>							
<b>previously reported</b>		\$ 103,476	\$ 599	\$ -	\$ (9,945)	\$ 56,353	\$ -
Change in accounting policies:	2						
Cumulative translation adjustment		-	-	(9,945)	9,945	-	-
<b>Balance at June 30, 2006, adjusted</b>		<b>103,476</b>	<b>599</b>	<b>(9,945)</b>	<b>-</b>	<b>56,353</b>	<b>-</b>
Common shares issued:	5						
Under the stock option plan		38	-	-	-	-	-
Under the stock purchase and ownership plan		28	-	-	-	-	-
Stock-based compensation		-	62	-	-	-	-
Net income		-	-	-	-	1,496	-
Cumulative translation adjustment		-	-	101	-	-	-
<b>Balance at September 30, 2006</b>		<b>\$103,542</b>	<b>\$ 661</b>	<b>\$ (9,844)</b>	<b>\$ -</b>	<b>\$ 57,849</b>	<b>\$ -</b>

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (cont'd)

For the six-month period ended September 30, 2006

	Notes	Capital Stock	Contributed surplus	Accumulated other comprehensive income (loss)	Cumulative translation adjustment	Retained earnings	Comprehensive income (loss)
<b>Balance at March 31, 2006, as previously reported</b>		\$ 103,447	\$ 544	\$ -	\$ (7,372)	\$ 55,665	\$ -
Change in accounting policies:	2						
Cumulative translation adjustment		-	-	(7,372)	7,372	-	-
<b>Balance at March 31, 2006, adjusted</b>		103,447	544	(7,372)	-	55,665	-
Common shares issued:	5						
Under the stock option plan		38	-	-	-	-	-
Under the stock purchase and ownership plan		57	-	-	-	-	-
Stock-based compensation expense	5	-	117	-	-	-	-
Net income		-	-	-	-	2,184	-
Cumulative translation adjustment		-	-	(2,472)	-	-	-
<b>Balance at September 30, 2006</b>		<b>\$103,542</b>	<b>\$ 661</b>	<b>\$ (9,844)</b>	<b>\$ -</b>	<b>57,849</b>	<b>\$ -</b>

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the periods ended September 30, 2007 and 2006

(In thousands of dollars) (Unaudited)

Notes	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
<b>Cash and cash equivalents provided by (used for):</b>				
<b>Operating activities</b>				
Net income	\$ 3,107	\$ 1,496	\$ 7,258	\$ 2,184
Items not requiring an outlay of cash:				
Amortization	2 4,072	4,226	8,307	8,367
Future income taxes	2 732	266	885	87
Amortization of deferred financing costs	4 30	68	76	137
Amortization of net deferred loss related to a financial derivative instrument	4 18	35	51	74
Accretion expense of asset retirement obligations and loans bearing no interest	223	47	465	94
Stock-based compensation expense	5 103	62	181	117
Cash flows from operations	\$ 8,285	\$ 6,200	\$ 17,223	\$ 11,060



## CONSOLIDATED STATEMENTS OF CASH FLOWS (cont'd)

For the periods ended September 30, 2007 and 2006  
(In thousands of dollars) (Unaudited)

	Notes	Quarters ended September 30		Six months ended September 30	
		2007	2006	2007	2006
Cash flows from operations		\$ 8,285	\$ 6,200	\$ 17,223	\$ 11,060
Net change in non-cash items related to operations	7	(3,527)	(9,976)	(14,642)	(21,204)
<b>Cash flows relating to operating activities</b>		<b>4,758</b>	<b>(3,776)</b>	<b>2,581</b>	<b>(10,144)</b>
<b>Investing activities</b>					
Purchase of property, plant and equipment and finite-life intangible assets		(10,393)	(3,878)	(15,114)	(5,941)
Proceeds on disposal of property, plant and equipment		-	2,171	-	2,171
Business acquisition – additional payments		-	-	-	(1,577)
<b>Cash flows relating to investing activities</b>		<b>(10,393)</b>	<b>(1,707)</b>	<b>(15,114)</b>	<b>(5,347)</b>
<b>Financing activities</b>					
Increase in long-term debt	4	-	6,495	-	6,495
Repayment of long-term debt	4	(641)	(583)	(4,187)	(2,963)
Issuance of common shares	5	56	66	529	95
<b>Cash flows relating to financing activities</b>		<b>(585)</b>	<b>5,978</b>	<b>(3,658)</b>	<b>3,627</b>
<b>Effect of changes in exchange rates on cash and cash equivalents</b>		<b>71</b>	<b>(288)</b>	<b>305</b>	<b>(444)</b>
<b>Change in cash and cash equivalents</b>		<b>(6,149)</b>	<b>207</b>	<b>(15,886)</b>	<b>(12,308)</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>10,387</b>	<b>8,348</b>	<b>20,124</b>	<b>20,863</b>
<b>Cash and cash equivalents at end of period</b>		<b>\$ 4,238</b>	<b>\$ 8,555</b>	<b>\$ 4,238</b>	<b>\$ 8,555</b>
<b>Supplemental information:</b>					
Interest paid		\$ 734	\$ 811	\$ 1,544	\$ 1,484
Income taxes paid		\$ 202	\$ 387	\$ 496	\$ 956

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

# NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the periods ended September 30, 2007 and 2006

(All dollar amounts in thousands, except share data) (Unaudited)

## NOTE 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The Interim consolidated financial statements include the accounts of Héroux-Devtek Inc. (the "Company") and its subsidiaries, all of which are wholly-owned.

The interim consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles applicable to interim financial statements and follow the same accounting policies and methods in their application as the most recent annual financial statements. In the opinion of Management, all adjustments necessary for a fair presentation are reflected in the interim financial statements. Such adjustments are of a normal and recurring nature. The results of operations for the interim periods are not necessarily indicative of the operating results for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended March 31, 2007.

## NOTE 2. CHANGES IN ACCOUNTING POLICIES

In April 2005, the Accounting Standards Board ("AcSB") issued three new accounting standards: Section 1530 "Comprehensive Income"; Section 3855 "Financial Instruments – Recognition and Measurement"; and Section 3865 "Hedges". Effective April 1, 2007, the Company adopted these new accounting standards. The comparative consolidated financial statements have not been restated. The effect of adopting the new accounting standards as at April 1, 2007 is presented as changes in accounting policies in the consolidated statement of changes in shareholders' equity.

Section 1530 introduces comprehensive income, which comprises net income and other comprehensive income (loss) ("OCI") and represents the changes in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources (not related to shareholders). OCI includes unrealized gains and losses, net of taxes, arising from the translation of the financial statements of self-sustaining foreign operations, as well as unrealized gains and losses, net of taxes, arising from changes in fair value of available-for-sale financial assets and the effective portion of changes in fair value of cash flow hedging instruments.

Section 3855 requires that financial instruments be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument. On initial recognition, all financial instruments subject to Section 3855, including embedded derivatives financial instruments that are not closely related to the host contract, are measured at fair value. The Company has selected April 1, 2003, as the date for identification of embedded derivatives. After initial recognition, the measurement of financial instruments depends on their classification: held for trading ("HFT"), available-for-sale ("AFS"), loans and receivables ("L&R"), held-to-maturity ("HTM") or other than HFT liabilities.

Financial assets and financial liabilities classified as HFT are measured at fair value, with gains and losses recognized to income for the period in which they arise. Financial assets classified as L&R or HTM and financial liabilities classified as other than HFT are measured at amortized cost using the effective interest method.

Financial assets classified as AFS are measured at fair value. Unrealized gains and losses including changes in foreign exchange rates are recognized directly to OCI, except for impairment losses, which are recognized to income, until the financial assets are derecognized, at which time the cumulative gains or losses previously recognized in accumulated OCI are recognized in income for the period.

## NOTE 2. CHANGES IN ACCOUNTING POLICIES (cont'd)

The Company has made the following classification of its financial instruments:

- Cash and cash equivalents are classified as HFT.
- Amounts receivable are classified as L&R.
- Amounts payable in current liabilities and long-term debt (including current portion) are classified as other than HFT liabilities.

Section 3865 specifies that in a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized to OCI, while the ineffective portion is recognized to income. The amounts recognized to OCI are reclassified to income in the period during which the hedged item affects income.

The Company elected to continue to apply hedge accounting for its forward foreign exchange contracts and for its interest rate swap agreement as cash flow hedges.

On adoption of these new standards, the transition rules require that the Company adjust the accumulated other comprehensive income (loss) as if the rules had always been applied in the past, without restating comparative figures for prior years. Accordingly, the following adjustments were recorded in the consolidated financial statements as at April 1, 2007:

	<b>April 1, 2007</b>
Current assets – Other current assets	\$ 5,220
Long-term assets – Property, plant and equipment, net	(1,003)
Long-term assets – Other assets	4,145
Current liabilities – Accounts payable and accrued liabilities	590
Current liabilities – Future income taxes	1,544
Current liabilities – Current portion of long-term debt	(113)
Long-term liabilities – Long-term debt	(3,475)
Long-term liabilities – Future income taxes	2,049
Long-term liabilities – Other liabilities	425
Accumulated other comprehensive income	5,597
Retained earnings	1,745

The adoption of these new standards also impacted the Company's second quarter and six-month period results ended September 30, 2007. During the three- and six-month periods ended September 30, 2007, this impact represented a reduction of \$115 and \$229 of the amortization expense and an increase of \$172 and \$363 of financial expenses respectively, totalling a net reduction of \$52 and \$88 of the Company's net income for these periods. However, this adoption of new standards had no impact on the Company's cash flows from operations and cash flows relating to operating activities for the three- and six-month periods ended September 30, 2007.

### NOTE 3. FINANCIAL INSTRUMENTS: FORWARD FOREIGN EXCHANGE CONTRACT AND INTEREST RATE SWAP AGREEMENT

#### Forward foreign exchange contracts

At September 30, 2007, Company had entered into forward foreign exchange contracts whereby it will sell at an average exchange rate of 1.1752 an amount of US\$109,500 (US\$129,500 at an average rate of 1.2110 as at March 31, 2007 and US\$123,500 at an average rate of 1.2484 as at September 30, 2006) for the purpose of foreign exchange risk management related essentially to its export sales and maturing at various dates between October 1, 2007 and March 31, 2011.

#### Interest rate swap agreement

On July 11, 2007, in order to limit the effect of interest rate variation over a portion of its long-term debt in U.S. currency, the Company entered into a four-year interest rate swap agreement for an amount of US \$15 million that fixes the Libor US rate at 5.53% and matures on August 1, 2011.

### NOTE 4. LONG-TERM DEBT

	September 30, 2007	March 31, 2007
Senior Secured Syndicated Revolving Credit Facilities ("Credit Facilities") of up to \$80,000 (see below), either in Canadian or U.S. currency equivalent, maturing on October 4, 2011, with no extension, which bear interest at bankers' acceptance plus 1.0% for the Canadian Credit Facilities at September 30, 2007 (representing an effective interest rate of 5.9%) and at Libor plus 1.0% at September 30, 2007 for the U.S. Credit Facilities (representing an effective interest rate of 6.1%) and bankers' acceptance plus 1.4% for the Canadian Credit facilities at March 31, 2007 (representing an effective interest rate of 5.7%), and Libor plus 1.4% at March 31, 2007 for the U.S. Credit Facilities (representing an effective interest rate of 5.6%).		
At September 30, 2007, the Company used \$12,000 (\$12,000 at March 31, 2007) and U.S.\$35,000 (U.S.\$35,000 at March 31, 2007) on the Credit Facilities.	\$ 46,818	\$ 52,411
Loans bearing no interest, repayable in variable annual instalments, with various expiry dates until 2013.	9,335	15,518
Obligations under capital leases bearing interest between 5.4% and 8.1% maturing between October 2007 and October 2009, with amortization periods varying between five to eight years, secured by the related property, plant and equipment, net of interest of \$272 (\$419 as at March 31, 2007).	4,424	5,848
Deferred financing costs	(735)	(824)
	<b>59,842</b>	<b>72,953</b>
Less: current portion	4,182	6,691
	<b>\$ 55,660</b>	<b>\$ 66,262</b>

The implementation of the new accounting standards (see note 2 – Changes in accounting policies) reduced the carrying value of the non-interest bearing loans by \$3,588 as at April 1, 2007.

## NOTE 4. LONG-TERM DEBT (cont'd)

### Secured Syndicated Revolving Credit Facilities

Last fiscal year, during the third quarter ended December 31, 2006, the Company successfully concluded the amendment and extension of its Credit Facilities for a five-year period whereas the previous revolving operating and term facilities were combined into Senior Secured Revolving Credit Facilities that will mature in five years, on October 4, 2011, with no extension.

These Credit Facilities allow the Company and its subsidiaries to borrow up to \$80,000 (either in Canadian and U.S. currency equivalent) from a group of banks and their American subsidiaries or branches and are used for working capital, capital expenditures and other general corporate purposes, are secured by all assets of the Company, and its subsidiaries and are subject to certain restrictive covenants and corporate guarantees granted by the Company and its subsidiaries.

Interest rates vary based on Prime, Bankers' acceptance, Libor or U.S. base rate plus a relevant margin depending on the level of the Company's indebtedness and cash flows.

These Credit Facilities are governed by two credit agreements (Canadian and American).

The financial expenses, for the periods ended September 30, are comprised of:

	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
Interest expense	\$ 1,458	\$ 777	\$ 2,666	\$ 1,586
Amortization of deferred financing costs	30	68	76	137
Standby fees	51	47	109	95
Accretion expense of asset retirement obligations	51	47	102	94
Amortization of net deferred loss related to financial derivative instrument	18	35	51	74
Interest revenue	(102)	(94)	(252)	(232)
Financial expenses	\$ 1,506	\$ 880	\$ 2,752	\$ 1,754

During the three- and six-month periods ended September 30, 2007, the implementation of the new accounting standards (see note 2 – Changes in accounting policies) increased the interest expense by \$172 and \$363, respectively.

## NOTE 5. CAPITAL STOCK

### Authorized capital stock

The authorized capital stock of the Company consists of the following:

An unlimited number of voting common shares, without par value;

An unlimited number of first preferred shares, issuable in series; and

An unlimited number of second preferred shares, issuable in series.

The rights, privileges, restrictions and conditions related to the preferred shares may be established by the Board of Directors.

The issued and outstanding capital stock of the Company consists of the following:

	Sept. 30, 2007	March 31, 2007
<b>31,625,168</b> common shares (31,528,017 at March 31, 2007)	<b>\$104,149</b>	\$103,620

### Issuance of common shares

During the three- and six-month periods ended September 30, 2007, the Company issued 6,430 common shares and 97,151 common shares respectively, at weighted average prices of \$8.63 and \$5.44 respectively for a total net cash consideration of \$56 and \$529. A number of 83,300 common shares were issued (all in the first quarter of fiscal 2008) following the exercise of stock options for a total cash consideration of \$413 and the remainder of 13,851 common shares were issued under the Company's stock purchase and ownership incentive plan for a total net cash consideration of \$116.

During the three- and six-month periods ended September 30, 2006, the Company issued 18,540 common shares and 25,437 common shares respectively, at weighted-average prices of \$3.56 and \$3.74 respectively for a total net cash consideration of \$66 and \$95. A number of 12,000 common shares were issued (all in the second quarter of fiscal 2007) following the exercise of stock options for a total cash consideration of \$38 and the remainder of 13,437 common shares were issued under the Company's stock purchase and ownership incentive plan for a total net cash consideration of \$57.

### Stock option plan

The Company has a stock option plan where options to purchase common shares are issued to officers and key employees. The Company expenses all granting of stock options based on their earned period, using the Black-Scholes valuation model to determine their fair value. The expense related to stock options recorded in the quarter ended September 30, 2007 amounted to \$103 (\$62 for the quarter ended September 30, 2006) and to \$181 for the six-month period ended September 30, 2007 (\$117 in 2006) and is included in the Company's selling and administrative expenses.

During the three- and six-month periods ended September 30, 2007, 355,000 stock options were granted (all in the second quarter of fiscal 2008) at a granted value of \$9.90 per share. These options are performance based and are vesting over a four-year period and can be exercised over a seven-year period.

During the three- and six-month periods ended September 30, 2006, 325,000 stock options were granted (all in the second quarter of fiscal 2007) at a granted value of \$4.79 per share. These options are performance based and are vesting over a three-year period and can be exercised over a seven-year period. During the same periods, 95,500 stock options were cancelled.

At September 30, 2007, the Company had 1,362,221 outstanding stock options at a weighted exercise average price of \$7.28 which will expire over the next seven years (between October 2007 and August 2014).

### Stock purchase and ownership incentive plan

The Company has a stock purchase and ownership incentive plan to induce management employees to hold, on a long-term basis, common shares of the Company.

During the three- and six-month periods ended September 30, 2007, 6,430 and 13,851 common shares were issued (93,309 since the beginning of the plan) and 2,833 and 6,121 common shares attributed to the participating employees respectively (41,420 since the beginning of the plan). For the three- and six-month periods ended September 30, 2007, the expense related to the attributed common shares amounting to \$28 and \$58 respectively, is recorded as compensation expense and is included in the Company's selling and administrative expenses.

## NOTE 5. CAPITAL STOCK (cont'd)

During the three- and six-month periods ended September 30, 2006, 6,539 and 13,437 common shares were issued (65,477 since the beginning of the plan) and 2,959 and 5,941 common shares were attributed to the participating employees respectively (29,399 since the beginning of the plan). For the three- and six-month periods ended September 30, 2006, the expense related to the attributed common shares amounting to \$15 and \$29 respectively, is recorded as compensation expense and is included in the Company's selling and administrative expenses.

### Stock appreciation right plan

The Company has a stock appreciation right plan (SAR) under which rights are issued to its non-employee directors. The SARs enables the participants to receive by way of bonus, on the exercise date of a SARs, a cash amount equal to the excess of the market price of the Company's common share over the granted price of the SARs. During the three- and six-month periods ended September 30, 2007, 24,000 SARs were granted (all in the second quarter of fiscal 2008) at a granted value of \$9.90 (24,000 SARs at a granted value of \$4.79 for the same period in 2006 and all in the second quarter of fiscal 2007). The SARs are expensed on an earned basis and their costs are determined based on the Company's common shares quoted market value over their granted price. During the three- and six-month periods ended September 30, 2007, an expense of \$275 was recorded (\$14 for the period ended September 30, 2006), all in the second quarters.

During the second quarter and six-months period ended September 30, 2007, 7,500 SARs were exercised at an average granted value of \$6.56 (none exercised for the same period of 2006) and 9,000 SARs were cancelled (none cancelled for the same period in 2006).

At September 30, 2007, on a cumulative basis 95,500 SARs were still outstanding at a weighted-average granted value of \$6.53 which expire at various dates between fiscal years 2009 and 2014.

## NOTE 6. PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

The Company has funded and unfunded defined benefit pension plans as well as defined contribution pension plans that provide pension benefits to its employees. Retirement benefits provided by the defined benefit pension plans are either based on years of service and flat amount, years of service and final average salary or set out by individual agreements.

Benefits provided by the post-retirement benefit plans are set out by individual agreements, which mostly provide for life insurance coverage and health care benefits. Since their amounts are not significant, they are not included in figures below.

Defined pension plan obligations are impacted by factors including interest rate, adjustments arising from plan amendments, changes in assumptions and experience gains or losses. The total pension plan costs for the periods ended September 30 are as follows:

	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
Defined benefit pension costs	\$ 396	\$ 258	\$ 767	\$ 569
Defined contribution pension costs	214	346	440	671
	\$ 610	\$ 604	\$ 1,207	\$ 1,240

## NOTE 7. NET CHANGE IN NON-CASH ITEMS RELATED TO OPERATIONS

The net change in non-cash items related to operations for the quarters ended September 30 can be detailed as follows:

	Quarters ended		Six months ended	
	September 30		September 30	
	2007	2006	2007	2006
Accounts receivable	\$ 391	\$ 1,311	\$ 6,829	\$ 4,415
Income tax receivable	(1,867)	(1,678)	(1,886)	(1,375)
Other receivables	4,906	(1,035)	(1,585)	2,475
Inventories	(4,394)	(10,204)	3,039	(16,696)
Prepaid expenses	109	752	(265)	271
Other current assets	1,535	(597)	248	(810)
Accounts payable and accrued liabilities, and other liabilities	(2,379)	3,592	(17,031)	(5,778)
Income tax payable	256	(2,166)	569	(2,705)
Effect of changes in exchange rate	(2,084)	49	(4,560)	(1,001)
	\$ (3,527)	\$ (9,976)	\$ (14,642)	\$ (21,204)



## NOTE 8. SEGMENTED INFORMATION

Quarters ended September 30

### Activity Segments

	2007			2006		
	Aerospace	Industrial	Total	Aerospace	Industrial	Total
Sales	\$ 62,071	\$ 7,687	\$ 69,758	\$ 56,204	\$ 6,465	\$ 62,669
Operating income (loss)	5,360	(160)	5,200	3,060	(747)	2,313
Financial expenses			1,506			880
Income before income tax expense (recovery)			3,694			1,433
Assets	306,839	19,143	325,982	288,715	20,452	309,167
Goodwill	34,357	891	35,248	36,446	1,001	37,447
Purchase of property, plant and equipment	9,851	540	10,391	3,070	789	3,859
Purchase of finite-life intangible assets	2	-	2	15	4	19
Amortization	3,472	600	4,072	3,460	766	4,226

### Geographic Segments

	2007			2006		
	Canada	U.S.	Total	Canada	U.S.	Total
Sales	\$ 50,599	\$ 19,159	\$ 69,758	\$ 46,135	\$ 16,534	\$ 62,669
Property plant and equipment, net	71,928	38,728	110,656	59,024	34,456	93,480
Finite-life intangible assets, net	864	5,045	5,909	1,729	6,526	8,255
Goodwill	17,534	17,714	35,248	17,534	19,913	37,447
<b>Export sales<sup>(1)</sup></b>	<b>\$ 27,336</b>			<b>\$ 27,309</b>		

64% of the Company's sales (68 % in 2006) were to US customers.

(1) Export sales are attributed to countries based on the location of the customers.

## NOTE 8. SEGMENTED INFORMATION (cont'd)

Six months ended September 30

### Activity Segments

	2007			2006		
	Aerospace	Industrial	Total	Aerospace	Industrial	Total
Sales	\$134,201	\$ 14,333	\$ 148,534	\$ 116,566	\$ 12,420	\$ 128,986
Operating income (loss)	11,785	(205)	11,580	5,231	(1,393)	3,838
Financial expenses			2,752			1,754
Income before income tax expense (recovery)			8,828			2,084
Assets	306,839	19,143	325,982	288,715	20,452	309,167
Goodwill	34,357	891	35,248	36,446	1,001	37,447
Purchase of property, plant and equipment	14,348	760	15,108	4,835	828	5,663
Purchase of finite-life intangible assets	6	-	6	274	4	278
Goodwill acquired	-	-	-	440	-	440
Amortization	7,045	1,262	8,307	7,144	1,223	8,367

### Geographic Segments

	2007			2006		
	Canada	U.S.	Total	Canada	U.S.	Total
Sales	\$ 107,662	\$ 40,872	\$ 148,534	\$ 94,805	\$ 34,181	\$ 128,986
Property plant and equipment, net	71,928	38,728	110,656	59,024	34,456	93,480
Finite-life intangible assets, net	864	5,045	5,909	1,729	6,526	8,255
Goodwill	17,534	17,714	35,248	17,534	19,913	37,447
Export sales <sup>(1)</sup>	\$ 59,296			\$ 56,395		

66% of the Company's sales (68% in 2006) were to US customers.

(1) Export sales are attributed to countries based on the location of the customers.

## NOTE 9. RECLASSIFICATION

Comparative figures for the consolidated financial statements for the periods ended September 30, 2006 have been reclassified to comply with the September 30, 2007 presentation.

# Management Discussion and Analysis of Financial Position and Operating Results

This Management Discussion and Analysis of Financial Position and Operating Results (MD&A) is intended to provide an overview of how the financial position of Héroux Devtek Inc. (“Héroux-Devtek” or “the Company”) changed between March 31, 2007 and September 30, 2007. It also compares the operating results and cash flows for the three- and six-month periods ended September 30, 2007 to those for the same period in the previous year. It should be read in conjunction with the audited consolidated financial statements dated March 31, 2007 and the related MD&A, both available on the Company’s website at [www.herouxdevtek.com](http://www.herouxdevtek.com), and with the interim consolidated financial statements of June 30, 2007 and September 30, 2007. Héroux-Devtek’s consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The Company reports its results in Canadian dollars. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

## 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 Company’s actual results to differ materially from those expressed in or implied by such statements.

Such factors include, but are not limited to: the impact of general 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; fluctuations in commodity prices or availability; foreign exchange and interest rates; stock market volatility; and the impact of accounting policies issued by Canadian and US standard setters. Some of these factors are further discussed under Risks and Uncertainties in the Company’s MD&A for the year ended March 31, 2007. Readers are cautioned that the foregoing list of factors that may affect future growth, results and performance is not exhaustive. Undue reliance should not be placed on forward-looking statements.

Although the Company believes that the expectations conveyed by the forward-looking statements are based on information available 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 Company or persons acting on its behalf, are expressly qualified in their entirety by these cautionary statements. Unless otherwise required by applicable securities laws, the Company expressly disclaims any intention, and assumes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

## OVERVIEW

Héroux-Devtek designs, develops, manufactures and repairs systems and components for two main market segments: Aerospace and Industrial. The Aerospace segment comprises the following:

- landing gear products;
- aerostructure products;
- aircraft engine components, market which is now being gradually exited by the Company.

The Industrial segment includes:

- industrial gas turbine products;
- other industrial products, including products for the wind energy market.

The Company maintained its positive trend and posted positive results for the eight consecutive quarter. This trend can be explained by the favourable market conditions that have prevailed over the last two years and the lean manufacturing initiatives introduced by the Company, as well as the improved performance of the Industrial sector. Again, the stronger Canadian dollar had, and will continue to have, a significant negative impact on Héroux-Devtek's results. However, the Company uses forward foreign exchange contracts to mitigate this risk.

## RESULTS OF OPERATIONS

### Consolidated Sales

Consolidated sales for the second quarter ended September 30, 2007 grew by 11.3% to \$69.8 million from \$62.7 million for the same period last year.

The increase in second quarter sales this year was mainly due to continued improved sales for commercial products, consisting mainly of landing gear products and also aerostructure products both for large aircraft. Growth in sales of business jets landing gear products as well as in sales of military products also explains this increase. The ongoing strength of the Canadian dollar against the US dollar once again had a negative impact on US dollar denominated sales, reducing total sales by \$3.4 million or 5.4% compared to last year.

Year-to-date consolidated sales now stand at \$148.5 million, \$19.5 million or 15.2% higher than the \$129.0 million posted after six months last year. The above-mentioned factors, being increased sales of large aircraft, business jets and military products, have also contributed to the year-to-date improvement. These military products sales were somewhat offset by reduced military repair and overhaul work due to sales mix with lower supplied material content. The exit of the Aircraft Engine Components market reduced by \$1.5 million the Company's six-month sales compared to the same period last year. Year-to-date, the stronger Canadian dollar reduced sales by \$4.9 million or 3.8% compared to last year.

The Company's sales for the Aerospace and Industrial segments were as follows:

Segment	Quarters ended September 30				Six months ended September 30			
	2007 (\$'000)	2006 (\$'000)	VARIANCE (\$'000)	%	2007 (\$'000)	2006 (\$'000)	VARIANCE (\$'000)	%
Aerospace								
Military								
Military sales to government	10,969	12,983	(2,014)	(15.5)	25,817	27,667	(1,850)	(6.7)
Military sales to civil customers	18,830	14,095	4,735	33.6	39,065	30,326	8,739	28.8
Total Military	29,799	27,078	2,721	10.0	64,882	57,993	6,889	11.9
Total Commercial	32,272	29,126	3,146	10.8	69,319	58,573	10,746	18.3
Total Aerospace	62,071	56,204	5,867	10.4	134,201	116,566	17,635	15.1
Total Industrial	7,687	6,465	1,222	18.9	14,333	12,420	1,913	15.4
Total	69,758	62,669	7,089	11.3	148,534	128,986	19,548	15.2

Comparative figures for the Aerospace segment of last year have been reclassified to comply with this year presentation.

## RESULTS OF OPERATIONS (cont'd)

### Aerospace Segment

Sales for the Aerospace segment, shown in the table above, can be broken down by product as follows:

Product	Quarter ended September 30				Six months ended September 30			
	2007	2006	VARIANCE		2007	2006	VARIANCE	
	(\$'000)	(\$'000)	(\$'000)	%	(\$'000)	(\$'000)	(\$'000)	%
Landing Gear	41,069	38,549	2,520	6.5	86,927	79,250	7,677	9.7
Aerostructure	20,472	16,669	3,803	22.8	46,523	35,017	11,506	32.9
Aircraft Engine Components	530	986	(456)	(46.2)	751	2,299	(1,548)	(67.3)
Total	62,071	56,204	5,867	10.4	134,201	116,566	17,635	15.1

For the second quarter ended September 30, 2007, overall sales for the Aerospace segment were up 10.4% to \$62.1 million compared to \$56.2 million for the same period last year.

During the second quarter, Landing Gear sales increased by \$2.5 million or 6.5% relative to the same period last year. This resulted from continued growth in sales of large commercial aircraft, mainly on the B777, B737 and A330-340 programs and from business jets, essentially from the Learjet 45 program. These were partially offset by reduced military repair and overhaul sales, as explained above.

Second quarter Aerostructure sales were \$20.5 million, \$3.8 million or 22.8% higher than last year. This reflects the increase in military products sales, namely for the Joint Strike Fighter (JSF) and F 16 programs, and to a lesser degree the schedule recovery of parts for the A330-340 commercial aircraft program.

As previously mentioned, the Company has essentially exited the aircraft engine components market, which explains the \$0.5 million drop in sales for this quarter. Residual sales are expected for the remainder of the year.

Year-to-date sales for the Aerospace segment increased 15.1% to \$134.2 million. This increase came from both the Landing Gear and Aerostructure divisions for the above mentioned reasons and also from additional military electronic enclosure sales from the Aerostructure division. Lastly, Aircraft Engine Components sales for the year-to-date declined in line with the Company's exit of this market.

### Industrial Segment

Sales for the Industrial segment were as follows:

Product	Quarters ended September 30				Six months ended September 30			
	2007	2006	VARIANCE		2007	2006	VARIANCE	
	(\$'000)	(\$'000)	(\$'000)	%	(\$'000)	(\$'000)	(\$'000)	%
Gas Turbine	3,921	3,361	560	16.7	7,391	5,811	1,580	27.2
Other Industrial	3,766	3,104	662	21.3	6,942	6,609	333	5.0
Total	7,687	6,465	1,222	18.9	14,333	12,420	1,913	15.4

Second quarter sales for the Industrial segment totalled \$7.7 million this year, 18.9% higher than last year while year-to-date sales increased 15.4% to \$14.3 million when compared to the first six months last year. The positive trend in Industrial Gas Turbine sales which started in the second quarter of fiscal 2007 continued in fiscal 2008, with sales improving by \$0.6 million for the second quarter and \$1.6 million for the first six months when compared to the same periods last year.

## RESULTS OF OPERATIONS (cont'd)

### Sales by Destination

The Company's sales by destination were as follows:

Destination	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
Canada	34%	31%	32%	30%
US	64%	68%	66%	68%
International	2%	1%	2%	2%
	100%	100%	100%	100%

Increased Canadian commercial sales and the exit of the Aircraft Engine market explain both the quarter and year-to-date variances to last year.

### Gross Profit

For the quarter ended September 30, 2007, consolidated gross profit as a percentage of sales was 13.5%, up 3.0% from 10.5% last year.

Gross profit was favourably impacted by higher sales volume and improved margins on certain contracts at the Aerostructure division and by the continued turnaround at the Gas Turbine division. These were somewhat partially offset by reduced military repair and overhaul sales at Landing Gear Division, as already explained above. The stronger Canadian dollar had a 0.9% negative impact on the consolidated gross profit margin in the quarter ended September 30, 2007, compared to the same period last year. The Company uses forward foreign exchange contracts to mitigate the risks related to fluctuations in the Canadian currency against the US currency.

For the six months ended September 30, 2007, consolidated gross profit as a percentage of sales stood at 13.5%, 4.2% higher than last year. Besides the higher sales volume and improved margins mentioned above, the development phase of the JSF program which trimmed Aerostructure division gross profit in the first quarter this year was not as significant an impediment to the division margins in the second quarter this year. The stronger Canadian dollar had a 0.3% negative impact on the consolidated gross profit, year-to-date, when compared to the same period last year.

The implementation of changes in accounting policies (see below) reduced the amortization expense in the second quarter of this year by \$115,000 (\$229,000 for the first six months) and marginally increased the gross profit by 0.1% (0.2% year-to-date).

### Selling and Administrative Expenses

Second quarter selling and administrative expenses were as follows:

	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
Selling and administrative expenses (\$'000)	4,229	4,259	8,469	8,177
% of sales	6.1	6.8	5.7	6.3

Second quarter selling and administrative expenses were at the same level as last year but 0.7% lower as a percentage of sales. Year-to-date, selling and administrative expenses were \$0.3 million higher than last year but 0.6% lower as a percentage of sales. These expenses were offset by a \$0.7 million gain on currency translation in the second quarter of fiscal 2008 compared to a gain of \$0.1 million for the same period last year. Year-to-date expenses were reduced by a \$1.3 million gain on currency translation compared to a \$0.9 million gain for the corresponding six months last year.

## RESULTS OF OPERATIONS (cont'd)

### Operating Income (Loss)

#### Aerospace Segment

Aerospace operating income, for the second quarter ended September 30, 2007, increased to \$5.4 million or 8.6% of sales from \$3.1 million or 5.4% of sales in the second quarter of last year, essentially reflecting higher sales and improved performance essentially from the Aerostructure division and improved margins following the exit of the aircraft engine components market at the Gas Turbine division.

Year-to-date, Aerospace operating income stood at \$11.8 million or 8.8% of sales, \$6.6 million better than the \$5.2 million, or 4.5% of sales, reported for the first six months of last year, for the same reasons explained above.

#### Industrial Segment

The Industrial operating loss of \$0.2 million for the second quarter of this year compares to a \$0.7 million operating loss for the same period last year, while the year-to-date Industrial operating loss was also \$0.2 million compared to a loss of \$1.4 million for the first six months of last year. These favourable variances reflect continued operational improvements, increase in margins and an increase in overall Industrial sales compared to last year.

#### Financial Expenses

Destination	Quarters ended September 30		Six months ended September 30	
	2007 (\$'000)	2006 (\$'000)	2007 (\$'000)	2006 (\$'000)
Interest expense	1,458	777	2,666	1,586
Amortization of deferred financing costs	30	68	76	137
Standby fees	51	47	109	95
Accretion expense of asset retirement obligations	51	47	102	94
Amortization of net deferred loss related to financial derivative instrument	18	35	51	74
Interest revenue	(102)	(94)	(252)	(232)
Financial expenses – net	1,506	880	2,752	1,754

Second quarter financial expenses stood at \$1.5 million, \$0.6 million higher than last year while the year-to-date financial expenses stood at \$2.8 million, \$1.0 million higher than last year. These increases can be explained by the higher average long-term debt due to additional working capital and capital expenditure investments required to support the Company's internal sales growth.

The implementation of the changes in accounting policies (see below) increased the financial expenses by \$172,000 in the second quarter this year and \$363,000 year-to-date.

#### Income Tax Expense

The Company's effective income tax rate for the six months ended September 30, 2007 was 17.8% compared to its blended Canadian statutory rate of 32.7%. This difference can be mainly explained by the favourable impact of permanent differences (\$350,000) and by the recognition of \$720,000 (including \$300,000 in the first quarter) in income tax benefits from the utilization of tax losses carried forward for which no income tax benefits had been recognized in prior years. The remainder represents favourable future tax adjustments.

The Company had tax losses carried forward and other temporary differences of \$4.5 million at September 30, 2007 (\$7.8 million at March 31, 2007) for which no related income tax assets or benefits have yet been recognized in the consolidated financial statements.

## RESULTS OF OPERATIONS (cont'd)

### Net Income

	<u>Quarters ended September 30</u>		<u>Six months ended September 30</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net income (\$'000)	<b>3,107</b>	1,496	<b>7,258</b>	2,184
Earnings per share – basic & diluted (\$)	<b>0.10</b>	0.05	<b>0.23</b>	0.07

The Company posted net income of \$3.1 million for the second quarter ended September 30, 2007, compared to net income of \$1.5 million for the quarter ended September 30, 2006. Year-to-date, net income stood at \$7.3 million, \$5.1 million higher than last year's net income of \$2.2 million. These results reflect the increased sales volume and improved gross profit margins in the Aerostructure and Gas Turbine divisions.

The implementation of the changes in accounting policies (see below) reduced the net income by \$36,000 in the second quarter this year and \$88,000 for the first six months of fiscal 2008.

Earnings per share figures are based on weighted-averages of 31,622,268 common shares outstanding for the second quarter of this year and 31,509,778 for the same period last year. Year-to-date earnings per share figures are based on weighted averages of 31,587,133 common shares outstanding this year and 31,501,315 for the same period last year. The increase in the number of shares is essentially due to the issuance of 6,430 common shares in the second quarter this year (13,851 common shares year-to-date) pursuant to the Company's stock purchase and ownership incentive plan and the issuance of 83,300 common shares following the exercise of stock options in the first quarter of this year (see Note 5 to the interim consolidated financial statements).

The basic and diluted earnings per share, for all periods covered by this MD&A, were the same since the 'in-the-money' outstanding options (see stock option plan section below) had no material impact on the weighted-average common shares outstanding.

On October 31, 2007, the date of this MD&A, the Company had 31,627,251 common shares outstanding.

## LIQUIDITY AND CAPITAL RESOURCES

### Operating Activities

Internally, the Company generated cash flows from operations and used cash flows for operating activities as follows:

	<u>Quarters ended September 30</u>		<u>Six months ended September 30</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	<u>(\$'000)</u>	<u>(\$'000)</u>	<u>(\$'000)</u>	<u>(\$'000)</u>
Cash flows from operations	<b>8,285</b>	6,200	<b>17,223</b>	11,060
Net change in non-cash items				
related to operations	<b>(3,527)</b>	(9,976)	<b>(14,642)</b>	(21,204)
Cash flows relating to operating activities	<b>4,758</b>	(3,776)	<b>2,581</b>	(10,144)

The second quarter improvement in cash flows from operations of \$2.1 million comes mainly from the improvement in net income and, to a lesser degree, from the increase in future income taxes.

The net change of \$3.5 million in non-cash items for the second quarter ended September 30, 2007, arose mainly from an increase in inventories of \$4.4 million in line with the upcoming increase in business activities, a \$2.4 million reduction in accounts payable and accrued liabilities, an increase of \$1.9 million in income tax receivable and a \$2.1 million negative impact coming from the translation of US denominated non monetary items. These were partially offset by a \$4.9 million reduction in other receivables following the collection of development costs for the JSF which were invoiced in the first quarter this year and a \$1.5 million reduction in other current assets (see Consolidated Balance Sheet section below).



## LIQUIDITY AND CAPITAL RESOURCES (cont'd)

The net change in non-cash items for the second quarter ended September 30, 2006, was mainly caused by a \$10.2 million increase in inventories, in line with the rising level of activity, and a \$2.2 million reduction in income tax payable. These changes were somewhat offset by a decrease of \$1.3 million in accounts receivable and an increase of \$3.6 million in accounts payable and accrued liabilities and other liabilities.

The net change in non-cash items for the first six months ended September 30, 2007 of \$14.6 million can be mainly explained by a decrease of \$17.0 million in accounts payable and accrued liabilities following the payment in the first quarter of this year of capital expenditures outstanding as at March 31, 2007 and payment of raw material received late in the last fiscal year. It also includes a \$4.6 million negative impact from the translation of US denominated non-monetary items. These were somewhat offset by a \$6.8 million reduction in accounts receivable driven by an improvement in collection and a \$3.0 million decrease in inventories (see Consolidated Balance Sheet section below).

The increase in cash flows from operations for the six months ended September 30, 2006, was also attributable to the improvement in net income, partially offset by lower future income taxes. The net change in non-cash items included an increase of \$16.7 million in inventories, in line with the activity levels, a reduction of \$5.8 million in accounts payable and accrued liabilities and other liabilities and a \$2.7 million reduction in income tax payable, offset by a \$4.4 million reduction in accounts receivable.

The implementation of the change in accounting policies (see below) had no impact on the cash flows from operations and cash flows relating to operating activities for the second quarter and the first six months ended September 30, 2007.

### Investing Activities

The Company's investing activities were as follows:

	<u>Quarters ended September 30</u>		<u>Six months ended September 30</u>	
	2007	2006	2007	2006
	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Purchase of property, plant and equipment and finite-life intangible assets	(10,393)	(3,878)	(15,114)	(5,941)
Proceeds on disposal of property, plant and equipment	-	2,171	-	2,171
Business acquisition, additional payments	-	-	-	(1,577)
Cash flows relating to investing activities	(10,393)	(1,707)	(15,114)	(5,347)

Purchase of property, plant and equipment and finite-life intangible assets (capital expenditures) totalled \$10.4 million in the second quarter of this fiscal year and \$15.1 million for the six months ended September 30, 2007. This compares to \$3.9 million in the second quarter last year and \$5.9 million after six months last fiscal year. In all, capital expenditures of about \$37 million are planned for the current fiscal year, including \$23 million which are related to the completion of the new manufacturing facility in Arlington, Texas, for the JSF program and for the renovation of the plating facility at the landing gear plant in Longueuil, Quebec.

The \$2.2 million proceeds on disposal of property, plant and equipment last year came from the sale of the Company's Tampa, Florida, facility which was closed some years ago while its operations were then transferred to the Cincinnati, Ohio, facility. The \$1.6 million business acquisition last year represents the final additional payments made regarding fiscal 2006 profitability performance in relation to the acquisition of Progressive on April 1, 2004.

## LIQUIDITY AND CAPITAL RESOURCES (cont'd)

### Financing Activities

The Company's financing activities were as follows:

	Quarters ended September 30		Six months ended September 30	
	2007	2006	2007	2006
	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Repayment of long-term debt	(641)	(583)	(4,187)	(2,963)
Increase in long-term debt	-	6,495	-	6,495
Issuance of common shares	56	66	529	95
Cash flows relating to financing activities	(585)	5,978	(3,658)	3,627

The cash flows relating to financing activities reflects, year-to-date this year, the capital repayment of \$4.2 in long-term debt while the Company had drawn \$3.5 million (net of \$3.0 million capital repayment) on its banks' credit facilities last year. The year-to-date increase in common shares issued resulted from the exercise of 83,300 options at an exercise price of \$4.96 per common share for a total of \$0.4 million and the issuance of 13,851 common shares under the employee stock purchase and ownership incentive plan for a total of \$0.1 million.

The issuance of common shares for the three and six months periods ended September 30, 2006, was for the employee stock purchase and ownership incentive plan (see Note 5 to the interim consolidated financial statements).

### Extension of Secured Syndicated Revolving Credit Facilities (Credit Facilities)

Last year, in the third quarter ended December 31, 2006, the Company successfully concluded the amendment and extension of its Credit Facilities for a five-year period, whereby the previous banks' revolving operating and term credit facilities were combined into Senior Secured Revolving credit facilities of \$80 million that will mature in about five years, on October 4, 2011, with no extension. These facilities are secured by all the assets of the Company and its subsidiaries and are subject to certain restrictive covenants and corporate guarantees granted by the Company and its subsidiaries. This agreement was concluded with a syndication of banks comprising National Bank of Canada, which also acted as the administrative agent, Bank of Nova Scotia, Toronto - Dominion Bank and Laurentian Bank of Canada (see Note 4 to the interim consolidated financial statements).

The Company was in compliance with all its restrictive debt covenants at September 30, 2007, and expects to remain so for the balance of the current fiscal year.

### Stock Option Plan

The Company has a stock option plan whereby options to purchase common shares are issued to officers and key employees. At September 30, 2007, the Company had 1,362,221 outstanding stock options at a weighted-average exercise price of \$7.28 that will expire over the next seven years (between October 2007 and August 2014). Included in these outstanding stock options is the granting of 355,000 stock options, in the second quarter ended September 30, 2007, at an exercise price of \$9.90. In the second quarter ended September 30, 2006, 325,000 stock options had been granted at an exercise price of \$4.79.

An aggregate of 2,808,257 shares are reserved for issuance under this plan, of which 336,718 had not yet been granted at September 30, 2007. The Company also has a stock purchase and ownership incentive plan for management employees and a stock appreciation rights plan for its non-employee directors. (See Note 5 to the interim consolidated financial statements).

## CONSOLIDATED BALANCE SHEETS

The following table itemizes and explains the significant changes to the consolidated balance sheets between March 31, 2007 and September 30, 2007:

Item	Change (\$ millions)	Explanation
Cash and cash equivalents	(15.9)	See consolidated statements of cash flows.
Accounts receivable	(6.8)	Increased level of business activity more than offset by improved accounts receivable collection. The impact of the stronger Canadian dollar, since March 31, 2007, on US denominated accounts receivable (\$2.0 million) also explains this reduction.
Inventories	(3.0)	Mainly reflects the invoicing of JSF development costs during the first quarter this year and increased focus on overall inventory levels.
Other current assets	11.4	Essentially reflects the recognition in the Company's balance sheets of financial instruments measured at fair value – see "Changes in accounting policies" below.
Property, plant and equipment, net	1.0	<p>Due to:</p> <ul style="list-style-type: none"> <li>• Purchase of capital assets (\$15.1 million);</li> </ul> <p>Net of:</p> <ul style="list-style-type: none"> <li>• Amortization (\$7.6 million);</li> <li>• A lower US exchange rate used to convert the net assets of self-sustaining US subsidiaries (\$5.8 million).</li> </ul> <p>It also reflects the recognition in the Company's balance sheet of financial instruments measured at fair value – see "Changes in accounting policies" below.</p>
Finite-life intangible assets, net (includes a \$4.8 million net backlog)	(0.9)	Represents mainly the amortization on the underlying value of the net backlog acquired as part of the acquisition of Progressive and the lower US exchange rate used to convert the net assets of self-sustaining US subsidiaries.
Other assets	7.7	Essentially reflects the recognition in the Company's sheet of the financial instruments measured at fair value – see "Changes in accounting policies" below.
Goodwill	(2.8)	Due to the lower US exchange rate used to convert the net assets of self-sustaining US subsidiaries.
Accounts payable and accrued liabilities	(17.0)	Mainly reflects the impact of the payment of increased raw material purchased at the end of the fourth quarter of last year and, the outstanding payment of capital expenditures, both made in the first quarter of this fiscal year. The impact of the stronger Canadian dollar, since March 31, 2007, on US denominated accounts payable and accrued liabilities (\$2.2 million) also explains this reduction.

## CONSOLIDATED BALANCE SHEETS (cont'd)

Item	Change	Explanation
(\$ millions)		
Future income taxes (current liabilities)	3.8	Reflects mainly the future income tax impact of the recognition in the Company's balance sheets of the financial instruments measured at fair value – see "Changes in accounting policies" below.
Long-term debt (including current portion)	(13.1)	<p>Due to:</p> <ul style="list-style-type: none"> <li>• Capital repayment of long-term debt (\$4.0 million); and</li> <li>• A lower US exchange rate used to convert the net assets of self-sustaining US subsidiaries (\$5.8 million).</li> </ul> <p>It also reflects the recognition in the Company's balance sheets of financial instruments measured at fair value – see "Changes in accounting policies" below.</p>
Future income taxes (Long-term liabilities)	3.3	Reflects mainly the future income tax impact of the recognition in the Company's balance sheets of the financial instruments measured at fair value – see "Changes in accounting policies" below.
Accumulated other comprehensive loss	4.8	Represents the counterpart of the impact of foreign exchange rate fluctuations on the net assets of self-sustaining US subsidiaries and the unrealized net gains, net of taxes, on the fair value of the financial instruments designated as cash flow hedges – see "Changes in accounting policies" below.
Retained earnings	9.0	See consolidated statements of changes in shareholders' equity and Changes in accounting policies, below.

At September 30, 2007 and March 31, 2007, the Company's working capital ratio, cash and cash equivalents and long-term debt-to-equity ratio were as follows:

	September 30, 2007	March 31, 2007
Working capital ratio	2.17:1	1.94:1
Cash and cash equivalents	\$4.2 million	\$20.1 million
Long-term debt-to-equity ratio	0.32:1	0.41:1

### OFF-BALANCE SHEET ITEMS AND COMMITMENTS

The Company had entered into operating leases amounting to \$11.2 million as at September 30, 2007 (\$12.9 million as at March 31, 2007), essentially for machinery and equipment. All these amounts are repayable over the next seven years. At September 30, 2007, the Company also had purchase commitments totalling \$11.3 million (\$20.2 million to March 31, 2007), mainly for machinery and equipment and construction in progress, for which \$1.8 million (\$2.0 million to March 31, 2007) deposits on machinery and equipment were made and are included in the Company's other current assets. These commitments mainly relate to the modernization of the Longueuil plant plating department and construction of a new manufacturing facility in Arlington, Texas.

At September 30, 2007, the Company had entered into forward foreign exchange contracts to sell US\$109.5 million at an average exchange rate of 1.1752 (US\$129.5 million at an average rate of 1.2110 as at March 31, 2007 and US\$123.5 million at an average rate of 1.2484 as at September 30, 2006) for the purpose of foreign exchange risk management, essentially related to its export sales. These contracts mature at various dates between October 2007 and March 2011, with the majority maturing in fiscal 2008 and 2009.

## OFF-BALANCE SHEET ITEMS AND COMMITMENTS (cont'd)

On July 11, 2007, in order to limit the effect of interest rate variations over the portion of its long-term debt in US currency, the Company entered into a four-year interest rate swap agreement for an amount of US\$15 million that fixes the Libor US rate at 5.53% and that will mature on August 1, 2011.

## CHANGES IN ACCOUNTING POLICIES

In April 2005, the Accounting Standards Board issued three new accounting standards: Section 1530 "Comprehensive Income", Section 3855 "Financial Instruments – Recognition and Measurement" and Section 3865 "Hedges». The Company adopted these new accounting standards effective April 1, 2007.

A new statement entitled "consolidated statement of changes in shareholders' equity" was added to the Company's interim consolidated financial statements and includes the changes in capital stock, contributed surplus and retained earnings as well as comprehensive income and accumulated other comprehensive income (loss).

Section 1530 introduces comprehensive income, which comprises net income and other comprehensive income (loss) ("OCI") and represents changes in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources (not related to shareholders). OCI includes unrealized gains and losses, net of taxes, arising from the translation of the financial statements of self-sustaining foreign operations, as well as unrealized gains and losses, net of taxes, arising from changes in fair value of available-for-sale financial assets and the effective portion of changes in fair value of cash flow hedging instruments.

Section 3855 requires that financial instruments be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument. On initial recognition, all financial instruments subject to Section 3855, including embedded derivatives financial instruments that are not closely related to the host contract, are measured at fair value. The Company has selected April 1, 2003, as the date for identification of embedded derivatives. After initial recognition, the measurement of financial instruments depends on their classification: held for trading ("HFT"), available-for-sale ("AFS"), loans and receivables ("L&R"), held-to-maturity ("HTM") or other than HFT liabilities.

Financial assets and financial liabilities classified as HFT are measured at fair value, with gains and losses recognized to income for the period in which they arise. Financial assets classified as L&R or HTM and financial liabilities classified as other than HFT are measured at amortized cost using the effective interest method.

Financial assets classified as AFS are measured at fair value. Unrealized gains and losses including changes in foreign exchange rates are recognized directly to OCI, except for impairment losses, which are recognized to income, until the financial assets are derecognized, at which time the cumulative gains or losses previously recognized in accumulated OCI are recognized in income for the period.

The Company has made the following classification of its financial instruments:

- Cash and cash equivalents are classified as HFT.
- Amounts receivable are classified as L&R.
- Amounts payable in current liabilities and long-term debt (including current portion) are classified as other than HFT liabilities.

Section 3865 specifies that in a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized to OCI, while the ineffective portion is recognized to income. The amounts recognized to OCI are reclassified to income in the period during which the hedged item affects income.

The Company elected to continue to apply hedge accounting for its forward foreign exchange contracts and for its interest rate swap agreement as cash flow hedges.

## CHANGES IN ACCOUNTING POLICIES (cont'd)

The impact of the implementation of these new accounting standards was recognized as an adjustment to the carrying amount of the related financial instruments and recorded in shareholders' equity as at April 1, 2007. This transition adjustment resulted in an increase of \$5.6 million recorded to accumulated OCI and, an increase of \$1.7 million recorded to retained earnings. The impact of these changes on the Company's consolidated balance sheet accounts at April 1st 2007 can be summarized as follows:

	April 1, 2007 Increase (decrease) (\$ million)
Current Assets - Other Current Assets	5.2
Long-term assets - Property, plant and equipment, net	(1.0)
Long-term Assets - Other Assets	4.1
Current Liabilities - Accounts Payable and accrued liabilities	0.6
Current Liabilities - Future Income Taxes	1.5
Long-term liabilities - Long-term debt	(3.6)
Long-term Liabilities - Other Liabilities	0.4
Long-term Liabilities - Future Income Taxes	2.0
Accumulated other comprehensive income	5.6
Retained earnings	1.7

The implementation of these new accounting standards reduced the Company's consolidated net income by \$36,000 for the second quarter this year and \$88,000 for the six months ended September 30, 2007, while it had no impact on cash flows from operations and cash flows relating to operating activities for the same period.

### Impact on the Company's consolidated net income for the three- and six-month periods ended September 30, 2007:

	Quarter ended September 30, 2007 (\$ '000)	Six months ended September 30, 2007 (\$ '000)
• Decrease in amortization expense	115	229
• Increase in financial expenses	(172)	(363)
	(57)	(134)
• Income tax impact	21	46
• Reduction in consolidated net income	(36)	(88)

These accounting standards and the impact of these changes on the Company's consolidated financial statements are discussed in Note 2 - Changes in Accounting Policies (see also the new Consolidated Statement of Changes in Shareholders' Equity).

## CONTROLS AND PROCEDURES

In accordance with the Canadian Securities Administrators Multilateral Instrument 52-109, the Company has filed certificates signed by the President and Chief Executive Officer and the Executive Vice-President and Chief Financial Officer that, among other things, report on the design of disclosure controls and procedures and the design of internal control over financial reporting.

The President and Chief Executive Officer and the Executive Vice-President and Chief Financial Officer have evaluated that there were no changes to the Company's internal controls over financial reporting during the first quarter ended June 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's 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 Company's business, financial condition and results of operations. Such risks and uncertainties include, but are not limited to, those mentioned below, which are more fully described in the Company's MD&A for the year ended March 31, 2007.

- Reliance on large customers
- Availability and cost of raw materials
- Operational risks
- 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

## OUTLOOK

The order books of large commercial aircraft manufacturers continue to be very strong, a situation conducive to further business opportunities for suppliers such as Héroux-Devtek. The military aerospace market also remains solid. Meanwhile, the power generation industry continues to improve, which should help restore operating profitability in the Industrial segment.

Given the Company's solid backlog, it continues to expect approximately 10% internal sales growth in fiscal 2008 compared to fiscal 2007. In light of the continued strength of the Canadian dollar toward the US currency, Héroux-Devtek must continue to improve or make productivity gains to maintain its competitiveness. The Company's significant capital expenditure investment program that will support the expected internal sales growth along with the additional training programs for the Company's employees should both contribute to improvements in productivity.

## ADDITIONAL INFORMATION AND CONTINUOUS DISCLOSURE

This MD&A was approved by the Audit Committee and the Board of Directors on October 31, 2007. Updated information on the Company, including the annual information form, can be found on the SEDAR web site at [www.sedar.com](http://www.sedar.com).



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**Share Listing**

Toronto Stock Exchange  
Ticker symbol: HRX