MANAGEMENT'S DISCUSSION AND ANALYSIS

Second quarter ended September 30, 2019

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OVERVIEW

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'', the ''Corporation'' or “Management”) evolved between March 31, 2019 and September 30, 2019. It also compares the operating results and cash flows for the quarter and six-month period ended September 30, 2019 to those of the same periods of the prior fiscal year.

This MD&A is based on the unaudited interim condensed consolidated financial statements for the quarter ended September 30, 2019, and should be read in conjunction with them as well as with the audited consolidated financial statements and MD&A for the fiscal year ended March 31, 2019, all of which are available on the Corporation’s website at www.herouxdevtek.com and on SEDAR at www.sedar.com. All amounts in this MD&A are in thousands of Canadian dollars unless otherwise indicated. This MD&A was approved by the Audit Committee and Board of Directors of the Corporation on November 7, 2019.

IFRS and non-IFRS financial measures

This MD&A contains both IFRS and non-IFRS financial measures. Non-IFRS financial measures are defined and reconciled to the most comparable IFRS measures in the *Non-IFRS Financial Measures* section under *Operating Results*.

Materiality for disclosures

Management determines whether information is material based on whether they believe a reasonable investor’s decision to buy, sell or hold securities of the Corporation would likely be influenced or changed should the information be omitted or misstated, and discloses material information accordingly.

FORWARD-LOOKING STATEMENTS

Certain statements in this MD&A, including those presented in the Guidance section, 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. These statements are provided for the purpose of assisting the reader in understanding the Corporation’s financial performance and prospects and to present management’s assessment of future plans and operations. The reader is cautioned that such statements may not be appropriate for other purposes.

They may be impacted by factors including, but not limited to: the impact of worldwide general economic conditions; 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; financial and operational performance of suppliers and customers; foreign exchange or interest rate fluctuations; and the impact of accounting policies issued by international standard setters. For further details, please see the Risk Management section of the Corporation’s MD&A for the fiscal year ended March 31, 2019. 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 management believes the expectations conveyed by these statements, and while they 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 and readers are advised that actual results may differ from expected results. 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.

HIGHLIGHTS

	Three months ended September 30,		Six months ended September 30,	
	2019[3]	2018	2019[3]	2018
Sales	$ 145,516	$ 95,665	$ 288,943	$ 181,435
Operating income	10,519	5,289	20,890	10,146
Adjusted operating income[1]	10,519	6,165	21,505	11,382
Adjusted EBITDA[1]	21,510	13,176	43,019	25,420
Net income	6,307	3,294	12,750	6,846
Adjusted net income[1]	6,307	4,405	13,266	8,191
Cash flows related to operating activities	12,504	11,687	16,199	20,137
Free cash flow[1]	7,248	8,152	5,660	14,520
In dollars per share				
EPS - basic and diluted	$ 0.18	$ 0.09	$ 0.36	$ 0.19
Adjusted EPS[1]	0.18	0.12	0.37	0.22
As at			September 30,	March 31, 2019
Funded backlog[2]			$ 769,000	$ 624,000

[1] Non-IFRS financial measure. Refer to the Non-IFRS financial measures section under Operating Results for definitions and reconciliations to the most comparable IFRS measures.
[2] Represents firm orders
[3] Fiscal 2020 results reflects the impact of the adoption of IFRS 16. Refer to New Accounting Standards section under Additional Information for further details

- Backlog increased to $769 million, compared to $624 million as at March 31, 2019, mainly due to an increased demand for our defense products combined with Alta's backlog from the business acquisition.
- During the quarter ended September 30, 2019, the Corporation achieved consolidated sales of $145.5 million, operating income of $10.5 million and adjusted EBITDA of $21.5 million, compared to $95.7 million, $5.3 million and $13.2 million during the same period last fiscal year.
- For the quarter ended September 30, 2019, the Corporation generated cash flows related to operating activities of $12.5 million, compared to $11.7 million during the same quarter last fiscal year and a free cash flow of $7.2 million compared to $8.2 million during the same quarter last fiscal year.
- On September 19, 2019, The Boeing Company announced the successful first test flight for the MQ-25 unmanned aerial refueler for which the Corporation will provide complete landing gear systems.

OPERATING RESULTS

	Quarters ended September 30,			Six months ended September 30,		
	2019	2018	*Variance*	2019	2018	*Variance*
Sales	$145,516	$ 95,665	*$ 49,851*	$288,943	$181,435	*$107,508*
Gross profit	22,214	15,473	*6,741*	46,439	28,539	*17,900*
Selling and administrative expenses	11,695	9,308	*2,387*	24,934	17,157	*7,777*
Adjusted operating income(1)	10,519	6,165	*4,354*	21,505	11,382	*10,123*
Non-recurring items	—	876	*(876)*	615	1,236	*(621)*
Operating income	10,519	5,289	*5,230*	20,890	10,146	*10,744*
Financial expenses	2,837	1,645	*1,192*	5,473	2,645	*2,828*
Income tax expense	1,375	350	*1,025*	2,667	655	*2,012*
Net income	$ 6,307	$ 3,294	*$ 3,013*	$ 12,750	$ 6,846	*$ 5,904*
Adjusted net income(1)	$ 6,307	$ 4,405	*$ 1,902*	$ 13,266	$ 8,191	*$ 5,075*
As a percentage of sales						
Gross profit	15.3%	16.2%	*-90 bps*	16.1%	15.7%	*40 bps*
Selling and administrative expenses	8.0%	9.7%	*-170 bps*	8.6%	9.5%	*-90 bps*
Operating income	7.2%	5.5%	*170 bps*	7.2%	5.6%	*160 bps*
Adjusted operating income(1)	7.2%	6.4%	*80 bps*	7.4%	6.3%	*110 bps*
In dollars per share						
EPS - basic and diluted	$ 0.18	$ 0.09	*$ 0.09*	$ 0.36	$ 0.19	*$ 0.17*
Adjusted EPS(1)	$ 0.18	$ 0.12	*$ 0.06*	$ 0.37	$ 0.22	*$ 0.15*

(1) Non-IFRS financial measure. Refer to the Non-IFRS financial measures section for definitions and reconciliations to the most comparable IFRS measures.

Sales

Sales by sector were as follows:

	Quarters ended September 30,					
	2019	2018	Acquisitions	FX impact	Net variance	
Commercial	$ 64,921	$ 47,025	$ 11,071	$ (246)	$ 7,071	15.0%
Defence(1)	80,595	48,640	25,071	(204)	7,088	14.6%
Total	$ 145,516	$ 95,665	$ 36,142	$ (450)	$ 14,159	14.8%

	Six months ended September 30,					
	2019	2018	Acquisitions	FX impact	Net variance	
Commercial	$ 132,362	$ 92,786	$ 27,062	$ 1,295	$ 11,219	12.1%
Defence(1)	156,581	88,649	53,686	1,532	12,714	14.3%
Total	$ 288,943	$ 181,435	$ 80,748	$ 2,827	$ 23,933	13.2%

(1) Includes defence sales to civil customers and governments.

Sales grew 52.1% to $145.5 million, up from $95.7 million for the quarter and grew 59.3% to $288.9 million, up from $181.4 million for the six-month period compared to the same period last year. This increase is coming from recent acquisitions, which contributed $36.1 million for the quarter and $80.7 million for the six-month period ended September 30, 2019. FX had a negative impact of $0.5 million during the quarter, but a favorable impact of $2.8 million for the six-month period ended September 30, 2019.

Following explanations present sales variations by sector excluding acquisitions and FX impact compared to last year :

Commercial

The $7.1 million and $11.2 million respective net increases in commercial sales for the quarter and six-month period ended September 30, were mainly driven by increased deliveries for the Boeing 777 and 777X programs.

Defence

The $7.1 million and $12.7 million net increases in defence sales for the quarter and six month period were mainly driven by:

- Increased aftermarket demand for the C-130 and KC-135 programs with AAR, the Leonardo C-27J and Sikorsky H-60;
- Production rate increases on the Lockheed Martin F-35 and Boeing CH-47 programs;
- Engineering progress on the new Boeing MQ-25 program;
- Higher spares demand for the Northrop Grumman RQ-4 program; and
- Production ramp-up of the Sikorsky CH-53K program.

Gross Profit

Gross profit as a percentage of sales decreased during the second quarter from 16.2% to 15.3% mainly due to the 0.6% negative net impact of exchange rate fluctuations and higher manufacturing costs at our Longueuil facility. These negative factors were partially offset by the positive impact of the Beaver and CESA acquisitions.

For the six-month period, gross profit increased from 15.7% to 16.1% compared to the same period last fiscal year, mainly due to the positive impact of the Beaver and CESA acquisitions, partially offset by the 0.3% negative net impact of exchange rate fluctuation and higher manufacturing costs at our Longueuil facility.

Selling and Administrative Expenses

When excluding gains and losses on translation of net monetary items, selling and administrative expenses represented 8.4% and 8.6% of sales for the quarter and six-month period, compared to 9.2% and 9.5% for the same periods last fiscal year. This decrease is mainly explained by higher sales volume.

Non-recurring items

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Non-recurring items in operating income				
Acquisition-related costs	$ —	$ 876	$ 615	$ 1,236
	$ —	$ 876	$ 615	$ 1,236
Non-recurring items in financial expenses				
Net gains on certain derivative financial instruments	$ —	$ 517	$ —	$ 391
	$ —	$ 517	$ —	$ 391

Acquisition-related costs

These costs mainly pertain to professional fees and expenses related to the acquisition of Alta this fiscal year and the acquisitions of CESA and Beaver last fiscal year.

Net gains on certain derivative financial instruments

These gains relate to derivative financial instruments acquired in order to mitigate foreign currency and interest rate risks arising from the purchase price and financing related to the acquisition of CESA last year.

Operating Income

Operating income increased from 5.5% to 7.2% of sales (or increased from 6.4% to 7.2% excluding non-recurring items) for the quarter and increased from 5.6% to 7.2% of sales (or increased from 6.3% to 7.4% excluding non-recurring items) for the six-month period compared to the same periods last fiscal year, mainly as a result of the factors described above.

Year-over-year, foreign exchange had a negligible impact on operating income for the quarter and six-month period.

Net Financial Expenses

	Quarters ended September 30,			Six months ended September 30,		
	2019	2018	*Variance*	2019	2018	*Variance*
Interest on long-term debt[1]	$ 1,647	$ 681	*$ 966*	$ 3,383	$ 1,400	*$ 1,983*
Interest related to government loans	783	603	*180*	1,263	1,192	*71*
Interest income on cash and cash equivalents	(20)	(270)	*250*	(54)	(664)	*610*
Other interest expense	427	631	*(204)*	881	717	*164*
	$ 2,837	$ 1,645	*$ 1,192*	$ 5,473	$ 2,645	*$ 2,828*
						As at
	September 30, 2019	March 31, 2019	*Variance*	September 30, 2018	March 31, 2018	*Variance*
Long-term debt, including current portion	$ 281,404	$ 260,306	*$ 21,098*	$ 248,428	$ 131,041	*$ 117,387*

[1]Refer to section New Accounting Standards for additional information about the impact of the adoption of IFRS 16 Leases

The $1.2 million and $2.8 million net increases in financial expenses for the quarter and six-month period when compared to the same periods last fiscal year mainly result from higher interest charges related to the financing of the four acquisitions completed since June 30, 2018. Long-term debt stood at $281.4 million as at September 30, 2019 compared to $131.0 million as at March 31, 2018.

Income Tax Expense

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Income before income tax expense	$ 7,682	$ 3,644	$ 15,417	$ 7,501
Income tax expense	1,375	350	2,667	655
Effective tax rate	17.9%	9.6%	17.3%	8.7%
Canadian blended statutory income tax rate	26.6%	26.6%	26.6%	26.6%

For the quarter ended September 30, 2019, the Corporation's effective income tax rate mainly reflected the favourable impact of results in other tax jurisdictions of $1.1 million ($0.9 million in Fiscal 2019), partially offset by non-deductible expenses totaling $0.1 million ($0.1 million in Fiscal 2019).

For the six-month period ended September 30, 2019, the Corporation's effective income tax rate mainly reflected the favourable impact of results in other tax jurisdictions of $2.0 million ($1.7 million in Fiscal 2019), partially offset by non-deductible expenses totaling $0.3 million ($0.2 million in Fiscal 2019).

Net Income

Net income increased from $3.3 million to $6.3 million during the quarter (or increased from $4.4 million to $6.3 million, excluding non-recurring items net of taxes) and increased from $6.8 million to $12.8 million during the six-month period (or increased from $8.2 million to $13.3 million, excluding non-recurring items net of taxes) compared to the same periods last fiscal year, mainly as a result of the factors described above.

NON-IFRS FINANCIAL MEASURES

This MD&A is based on earnings in accordance with IFRS and the following non-IFRS financial measures:

Adjusted operating income:	Operating income excluding non-recurring items.
EBITDA:	Earnings before financial expenses, income tax expense and amortization expense.
Adjusted EBITDA:	EBITDA as defined above excluding non-recurring items.
Adjusted net income:	Net income excluding non-recurring items net of taxes.
Adjusted earnings per share:	Diluted earnings per share calculated on the basis of adjusted net income.
Free cash flow:	Cash flows related to operating activities, less additions to property, plant and equipment and net increase or decrease in finite-life intangible assets.

These Non-IFRS financial measures do not have any standardized meaning prescribed by IFRS and may therefore not be comparable to similar measures presented by other issuers. Management considers these metrics to be information which may assist investors in evaluating the Corporation's profitability and enable better comparability of the results from one period to another and with peers who may employ similar measures.

These measures are not considered by management to be a substitute for IFRS measures, nor to be superior as they often do not fully reflect periodic costs, the long-term costs of investing or financing decisions or the impact of events which are not a result of operations.

The following are reconciliations of these items to their most comparable IFRS measures as well as additional information on what they represent, excluding free cash flow. For the reconciliation of free cash flow to cash flows related to operating activities, refer to *Liquidity and Capital Resources*.

The Corporation's adjusted operating income is calculated as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Operating income	$ 10,519	$ 5,289	$ 20,890	$ 10,146
Non-recurring items	—	876	615	1,236
Adjusted operating income	$ 10,519	$ 6,165	$ 21,505	$ 11,382

Management believes adjusted operating income provides investors with a figure that provides an alternative assessment of the Corporation's future profitability by excluding from operating income the impact of events which are not in the expected course of future operations, or which are not a result of operations.

The Corporation's EBITDA and adjusted EBITDA are calculated as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Net income	$ 6,307	$ 3,294	$ 12,750	$ 6,846
Income tax expense	1,375	350	2,667	655
Net financial expenses	2,837	1,645	5,473	2,645
Amortization expense	10,991	7,011	21,514	14,038
EBITDA	$ 21,510	$ 12,300	$ 42,404	$ 24,184
Non-recurring items	—	876	615	1,236
Adjusted EBITDA	$ 21,510	$ 13,176	$ 43,019	$ 25,420

Management believes EBITDA and adjusted EBITDA provide valuable insight into the Corporation's day-to-day operations as they exclude from earnings factors that are more reflective of long-term financing or investing decisions than of current performance.

Adjusted EBITDA, in addition, provides an alternative assessment of future operating results as it excludes the impact of events which are not in the expected course of future operations, or which are not a result of operations. Adjusted EBITDA is also used by management to assess operational performance and is a component of certain performance-based employee remuneration.

The Corporation's adjusted net income and adjusted earnings per share are calculated as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Net income	$ 6,307	$ 3,294	$ 12,750	$ 6,846
Non-recurring items, net of taxes	—	1,111	516	1,345
Adjusted net income	$ 6,307	$ 4,405	$ 13,266	$ 8,191
In dollars per share				
Earnings per share - basic and diluted	$ 0.18	$ 0.09	$ 0.36	$ 0.19
Non-recurring items, net of taxes	—	0.03	0.01	0.03
Adjusted earnings per share	$ 0.18	$ 0.12	$ 0.37	$ 0.22

Management believes adjusted net income and adjusted earnings per share provide investors with an alternative assessment of the Corporation's current period results and future earnings prospects as they exclude from earnings the impact of events which are of a non-recurring nature or do not reflect current operations.

Free cash flow is explained and reconciled in *Liquidity and Capital Resources*.

BUSINESS ACQUISITIONS

Acquisition of Alta

On June 7, 2019, the Corporation completed the acquisition of all of the shares of Alta Précision Inc. ("Alta"), for $18.6 million, including a $0.5 million balance of sale and the assumption of Alta's net outstanding debt amounting to $0.9 million. Located in Montreal, Canada, Alta is a manufacturer of high-precision landing gear components. This acquisition expands the Corporation's portfolio of commercial products by providing both access to new programs and additional content on existing platforms. The acquisition was financed with the Corporations available credit facilities and was treated as a business combination.

Alta was a minority shareholder of Tekalia. As a result of the acquisition, the Corporation increased its participation in Tekalia to 67% from 60% as at March 31, 2019.

Purchase Price

The preliminary purchase price allocation that reflect the fair value of the assets acquired and liabilities assumed during Fiscal 2020 with any excess allocated to goodwill was prepared using the acquisition method as follows:

	Alta
Cash payment	$ 17,149
Long-term debt assumed (1)	903
Balance of purchase price payable	500
Total purchase price	$ 18,552

(1) *Excludes lease liability related to IFRS 16*

Purchase Price Allocation

	Purchase price allocation as originally reported	Adjustments and reclassifications	Adjusted purchase price allocation
Accounts receivable	$ 1,451	$ 4	$ 1,455
Inventories	11,374	193	11,567
Other current assets	439	(63)	376
	13,264	**134**	**13,398**
Property, plant and equipment, including right-of-use	18,040	1,506	19,546
Finite-life intangible assets	—	2,797	2,797
Deferred income tax assets	—	1,858	1,858
Other long-term assets	264	—	264
Investment in Tekalia	544	—	544
Total identifiable assets	**$ 32,112**	**$ 6,295**	**$ 38,407**
Accounts payable and accrued liabilities	6,866	(237)	6,629
Customer advances and progress billings	2,872	—	2,872
Provisions	906	6,012	6,918
Long-term debt (1)	6,844	—	6,844
Total identifiable liabilities	**$ 17,488**	**$ 5,775**	**$ 23,263**
Net identifiable assets and liabilities	**14,624**	**520**	**15,144**
Goodwill and other intangible assets	3,928	(3,928)	—
Goodwill	—	3,408	3,408
Total purchase price	**$ 18,552**	**$ —**	**$ 18,552**

(1) Corresponds to lease liabilities

During the quarter ended September 30, 2019, the Corporation amended its assessment of the fair value of certain customers' contracts, property, plant and equipment and finite-life intangible assets. The purchase price allocation remain preliminary for these items and their related tax impacts until management has gathered all the necessary information to complete the process.

Acquisition of CESA

During the quarter ended September 30, 2019, the Corporation completed its final assessment of the fair value of assets acquired and liabilities assumed of Compañia Española de Sistemas Aeronauticos S.A. ("CESA"). Adjustments and reclassifications mainly relate to the final assessment of costs and liabilities associated to specific Aerospace programs.

Purchase Price Allocation

	Purchase price allocation as originally reported	Adjustments and reclassifications	Final purchase price allocation
Accounts receivable	$ 28,293	$ —	$ 28,293
Inventories	36,692	—	36,692
Income tax receivable	505	—	505
Other current assets	596	—	596
	66,086	**—**	**66,086**
Property, plant and equipment	44,923	—	44,923
Finite-life intangible assets	40,407	—	40,407
Other long-term assets - Tax credits receivable	7,843	—	7,843
Total identifiable assets	**$ 159,259**	**$ —**	**$ 159,259**
Accounts payable and accrued liabilities	16,773	—	16,773
Provisions	11,897	4,506	16,403
Customer advances and progress billings	4,188	—	4,188
	32,858	**4,506**	**37,364**
Provisions	4,308	—	4,308
Deferred income tax liabilities	3,465	(1,126)	2,339
Other liabilities - long-term accounts payable	4,365	—	4,365
Total identifiable liabilities	**$ 44,996**	**$ 3,380**	**$ 48,376**
Net identifiable assets and liabilities	**114,263**	**(3,380)**	**110,883**
Goodwill	81,553	3,380	84,933
Total purchase price	**$ 195,816**	**$ —**	**$ 195,816**

LIQUIDITY AND CAPITAL RESOURCES

CREDIT FACILITIES AND NET DEBT POSITION

Senior Secured Syndicated Revolving Credit Facility ("Revolving Facility")

The Corporation has a Revolving 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 facility allows the Corporation and its subsidiaries to borrow up to $250.0 million, either in Canadian dollars, US dollars, British Pounds, Euro or equivalent currencies and will mature in May 2022. It also includes an accordion feature to increase available credit by an additional $100.0 million during the term of this agreement, subject to the approval of the lenders.

As at September 30, 2019, the Corporation had $90.1 million drawn against the Revolving Facility, compared to $94.9 million as at March 31, 2019. This decrease is mainly related to a US$12.0 million ($15.9 million) repayment net of US$9.0 million ($12.1 million) drawing made in order to finance the Alta acquisition.

Unsecured Subordinated Term Loan Facility ("Term Loan Facility")

The Corporation has a Term Loan Facility with *Fonds de Solidarité FTQ* for an amount of up to $75.0 million. The facility consists of a $50.0 million term loan related to the acquisition of CESA and additional financing, available until September 30, 2020, of up to $25.0 million subject to certain conditions of which a $10.0 million tranche was drawn in connection with the acquisition of Alta.

The initial $50.0 million loan, drawn on September 25, 2018, bears interest at 5.70% and is repayable at maturity on September 30, 2025. The second tranche of $10.0 million drawn on June 11, 2019, bears interest at 4.73% and is also repayable at maturity on September 30, 2025. Starting on September 30, 2021, the Corporation will have the option to make early repayments subject to certain fees.

Net Debt Position

	September 30, 2019	April 1, 2019 (2)	March 31, 2019
Long-term debt, including current portion(1)	$ 284,282	$ 278,150	$ 263,258
Less: Cash and cash equivalents	19,630	35,128	35,128
Net debt position	$ 264,652	$ 243,022	$ 228,130

(1) *Excluding net deferred financing costs of $2.9 million and $3.0 million as at September 30, 2019 and March 31, 2019, respectively.*

(2) *Pro-forma including the effect of the adoption of IFRS 16,* Leases.

On April 1, 2019, the Corporation adopted the new IFRS 16, *Leases* accounting standard (Refer to the *New Accounting Standards* under *Additional Information* for further details). The new standard requires all leases to be recognized as debt on the Corporation's balance sheet. As a result, long-term debt included $14.9 million and $26.7 million of leases as at April 1, 2019 and September 30, 2019, respectively, which would have been accounted for as operating leases under the previous standard.

Considering the Corporation's cash and cash equivalents position, its available credit facilities and level of expected capital investments and results, the Corporation's management does not expect any significant liquidity risk in the foreseeable future.

VARIATIONS IN CASH AND CASH EQUIVALENTS

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Cash and cash equivalents at beginning of periods	$ 36,965	$ 99,000	$ 35,128	$ 93,209
Cash flows related to operating activities	12,504	11,687	16,199	20,137
Cash flows related to investing activities	(5,256)	(27,549)	(23,663)	(30,045)
Cash flows related to financing activities	(24,605)	114,169	(7,659)	113,237
Effect of changes in exchange rates on cash and cash equivalents	22	(590)	(375)	179
Cash and cash equivalents at end of periods	$ 19,630	$ 196,717	$ 19,630	$ 196,717

Operating Activities

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

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Cash flows from operations	$ 18,834	$ 10,357	$ 35,787	$ 21,247
Net change in non-cash items	(6,330)	1,330	(19,588)	(1,110)
Cash flows related to operating activities	$ 12,504	$ 11,687	$ 16,199	$ 20,137

For the quarter and six-month period ended September 30, 2019, the respective increases of $8.5 million and $14.5 million in cash flows from operations compared to the same periods last year mainly relate to the contribution of CESA as well as increased volume in the legacy businesses.

The net change in non-cash items can be summarized as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Accounts receivable	$ 332	$ 5,935	$ 14,955	$ 24,663
Inventories	(12,611)	(597)	(23,330)	(4,237)
Other current assets	2,125	1,794	(1,120)	662
Accounts payable and accrued liabilities	5,995	833	(3,043)	(9,779)
Income taxes payable and receivable	51	176	(279)	(1,666)
Customer advances and progress billings	732	(4,584)	155	(4,613)
Provisions	(1,297)	(1,141)	(2,345)	(4,113)
Effect of changes in exchange rates	(1,657)	(1,086)	(4,581)	(2,027)
	$ (6,330)	$ 1,330	$ (19,588)	$ (1,110)

For the quarter ended September 30, 2019, the negative net change in non-cash items mainly reflects an increase in inventory due to upcoming organic growth on the Boeing F18 and MQ-25 programs, partially offset by an associated increase in accounts payable at the end of the quarter when compared to June 30, 2019.

For the six-month period ended September 30, 2019, the negative net change in non-cash items mainly reflects:

- An increase in inventory due to the above-mentioned upcoming organic growth;
- A lower number of days payables outstanding at the end of September when compared to March 31, 2019; and
- The negative effect of changes in exchange rates.

These factors were partially offset by the seasonal decrease in accounts receivable following the higher level of activity during the fourth quarter of the prior fiscal year.

For the quarter ended September 30, 2018, the positive net change in non-cash items mainly reflects a reduction in accounts receivable, partly offset by a decrease in customer advances following revenue recognition and a decrease in accounts payable and accrued liabilities.

For the six-month period ended September 30, 2018, the negative net change in non-cash items mainly reflects:
- The seasonal decrease in accounts payable following the higher level of activity during the fourth quarter of the prior fiscal year;
- A decrease in customer advances following revenue recognition;
- An increase in inventories mainly related to the ramp-up of the Boeing 777 and 777X programs; and,
- A decrease in provisions mainly due to utilization of the restructuring provision;

These negative factors were partly offset by the seasonal decrease in accounts receivable following the higher level of activity during the fourth quarter of the prior fiscal year.

Investing Activities

The Corporation's investing activities were as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Cash payments for business acquisitions	$ —	$ (23,671)	$ (17,149)	$ (23,671)
Net additions to property, plant and equipment	(4,291)	(3,281)	(8,155)	(5,354)
Net increase in finite-life intangible assets	(965)	(604)	(2,384)	(1,027)
Proceeds on disposal of property, plant and equipment	—	7	4,025	7
Cash flows related to investing activities	$ (5,256)	$ (27,549)	$ (23,663)	$ (30,045)

The decrease in cash used related to investing activities for the quarter and compared to the same period last fiscal year mainly relates to the $23.7 million payment made for the acquisition of Beaver in Fiscal 2019 as well as the increase in net additions to property, plant and equipment related to the business acquisitions.

This table reconciles the additions to property, plant and equipment for the quarters and the six-month periods ended September 30:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Additions to property, plant and equipment	$ 5,294	$ 2,931	$ 14,455	$ 4,590
Variation in unpaid additions included in Accounts payable - other and other liabilities	(580)	350	309	764
Non-cash additions made through leasing agreements	(423)	—	(6,609)	—
Additions, as per statements of cash flows	$ 4,291	$ 3,281	$ 8,155	$ 5,354

Financing Activities

The Corporation's financing activities were as follows:

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Increase in long-term debt	$ 124	$ 116,605	$ 23,044	$ 116,605
Repayment of long-term debt	(24,725)	(1,545)	(30,355)	(2,818)
Issuance of common shares	—	450	—	791
Increase in deferred financing costs	(4)	(1,341)	(348)	(1,341)
Cash flows related to financing activities	$ (24,605)	$ 114,169	$ (7,659)	$ 113,237

The increased repayments of long-term debt during the quarter and six-month period compared to the same periods last fiscal year, mainly relate to a $15.9 million repayment (US$12.0 million) on the Revolving facility and the impact of payments made on leases which would have been accounted for as operating prior to the adoption of IFRS 16 (See *New Accounting Standards* under *Additional Information* for further details).

The increase in long-term debt during the six-month period is mainly related to a US$9.0 million ($12.1 million) drawing on the Revolving Facility and a $10.0 million drawing on the Term Loan Facility, both used to finance the acquisition of Alta.

As at September 30, 2019, the Corporation was in compliance with all of its restrictive debt covenants and expects to continue to comply with these restrictive financial covenants through the current fiscal year.

FREE CASH FLOW(1)

	Three months ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
Cash flows related to operating activities	$ 12,504	$ 11,687	$ 16,199	$ 20,137
Net additions to property, plant and equipment	(4,291)	(2,931)	(8,155)	(4,590)
Net increase in finite-life intangible assets	(965)	(604)	(2,384)	(1,027)
Free cash flow	$ 7,248	$ 8,152	$ 5,660	$ 14,520

(1) *Non-IFRS financial measure. Refer to the* Non-IFRS financial measures *section under* Operating Results *for the definition of this metric.*

Management considers free cash flow to be a good indicator of financial strength and profitability because it shows how much cash generated by operations is available for distribution, to repay debt or fund other investments.

FINANCIAL POSITION

ISSUED CAPITAL

Capital stock varied as follows:

	Quarter ended September 30, 2019		Six months ended September 30, 2019	
	Number	**Issued capital**	Number	Issued capital
Opening balance	36,362,210	$ 79,676	36,362,210	$79,676
Closing balance	36,362,210	$ 79,676	36,362,210	$79,676

No shares were issued during the six-month period ended September 30, 2019 and as at November 7, 2019, the number of common shares outstanding stood at 36,362,210.

Stock options varied as follows:

	Quarter ended September 30, 2019		Six months ended September 30, 2019	
	Number of stock options	Weighted-average exercise price	Number of stock options	Weighted-average exercise price
Opening balance	1,508,595	$ 13.87	1,167,095	$ 13.23
Granted	—	—	341,500	16.03
Closing balance	1,508,595	$ 13.87	1,508,595	$ 13.87

The Corporation grants stock options at a subscription price representing the average closing price of the Corporation's common shares on the Toronto Stock Exchange for the five trading days preceding the grant date. 2,808,257 common shares are reserved for issuance by the Corporation of which 2,762,507 had not been issued yet at September 30, 2019 (2,762,507 as at March 31, 2019).

As at November 7, 2019, the number of stock options outstanding stood at 1,508,595.

CONSOLIDATED BALANCE SHEETS

The acquisition of Alta contributed assets and liabilities to the Corporation's balance sheet as at September 30, 2019, as detailed in the *Business Acquisitions* section under *Operating Result*.

Working capital

As at	September 30, 2019	April 1, 2019	March 31, 2019	*Variance*	
Current assets	$ 373,920	$ 364,467	$ 364,467	*$ 9,453*	*2.6%*
Current liabilities	199,251	193,860	191,340	*5,391*	*2.8%*
Working capital	$ 174,669	$ 170,607	$ 173,127	*$ 4,062*	*2.3%*
Working capital ratio	1.88	1.88	1.90		

(1) Pro-forma including the effect of the adoption of IFRS 16 Leases.

The $9.5 million increase in current assets is mainly due to $13.6 million of current assets acquired with Alta.

The $5.4 million increase in current liabilities is mainly due to $12.1 million of current liabilities acquired with Alta.

Long-term assets, Long-term liabilities and Shareholders' Equity

The Corporation's long-term assets and liabilities were as follows, as at:

	September 30, 2019	April 1, 2019 (2)	March 31, 2019	*Variance*	
Long-term assets	$ 538,771	$ 527,791	$ 513,648	*$ 10,980*	*2.1 %*
Long-term liabilities	$ 310,701	$ 295,049	$ 282,677	*$ 15,652*	*5.3 %*
Shareholders' equity	$ 402,739	$ 404,098	$ 404,098	*$ (1,359)*	*(0.3)%*
Net debt-to-equity ratio(1)	0.66:1	0.60:1	0.56:1		

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

(2) Pro-forma including the effect of the adoption of IFRS 16 Leases.

The increase in long-term assets is mainly due to $28.2 million acquired with Alta, partially offset by the unfavourable effect of exchange rate fluctuations on the conversion of the Corporation's foreign operations.

The increase in long-term liabilities is mainly due to the acquisition and financing of Alta totaling $35.0 million, including lease liabilities, as well as a $4.3 million increase in the pension liability and a $3.6 million increase in progress billings, partially offset by debt repayments of $30.4 million.

ADDITIONAL INFORMATION

FOREIGN EXCHANGE ("FX")

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, in British pounds ("GBP") and in Euros ("EUR"). Transactions denominated in foreign currencies are initially recorded at the functional currency rate of exchange at the date of the transactions, excluding the impact of forward foreign exchange contracts ("FFEC"), while the statement of income of foreign operations is translated at the average exchange rate for the period.

The foreign exchange rates used to translate assets and liabilities into Canadian dollars were as follows, as at:

	September 30, 2019	March 31, 2019
USD (Canadian equivalent of US$1.0)	1.3243	1.3363
GBP (Canadian equivalent of £1.0)	1.6290	1.7418
EUR (Canadian equivalent of €1.0)	1.4438	1.5002

The foreign exchange rates used to translate revenues and expenses into Canadian dollars were as follows:

	Quarters ended September 30,		Six months ended September 30,	
	2019	2018	2019	2018
USD (Canadian equivalent of US$1.0)	1.3206	1.3069	1.3291	1.2991
GBP (Canadian equivalent of £1.0)	1.6280	1.7039	1.6735	1.7303
EUR (Canadian equivalent of €1.0)	1.4677	N/A	1.4855	N/A

The Corporation manages its exposure to fluctuations in FX rates using FFEC. Therefore, the variances in the rates presented above may not be representative of the actual impact of FX on financial results.

DERIVATIVES

Forward foreign exchange contracts

As at September 30, 2019, the Corporation had forward foreign exchange contracts outstanding for a notional amount of $295.0 million ($228.4 million at March 31, 2019) denominated in USD, EUR and and GBP. This amount includes contracts with nominal value of US$190.7 million (US$146.9 million at March 31, 2019) convertible into Canadian dollars at an average rate of 1.3145 (1.3060 at March 31, 2019). These contracts mature at various dates between October 2019 and March 2023, with the majority maturing this fiscal year and the next.

Cross-currency interest rate swaps

As at September 30, 2019, the Corporation had entered into the following cross-currency interest rate swap agreements in order to mitigate foreign exchange and interest rate risks:

	Notional	EURO equivalent	Interest rate	Inception	Maturity
US$	29,370	€ 25,000	1.86 %	October 2017	May 2022
C$	50,000	€ 34,110	3.40 %	October 2017	September 2025
US$	17,523	€ 15,000	Euribor 1 month + 1.74%	September 2018	May 2022
US$	17,100	€ 15,000	Euribor 1 month + 1.76%	November 2018	March 2020
C$	10,000	€ 6,658	2.68 %	June 2019	September 2025

Equity swap agreement

As at September 30, 2019, the Corporation had entered into an equity swap agreement fixing 300,000 common shares of the Corporation (245,000 at March 31, 2019) at a price of $13.52 ($12.68 at March 31, 2019). This agreement is a derivative that is not part of a designated hedging relationship and matures in June 2020.

NEW ACCOUNTING STANDARDS

The Company adopted the following new accounting standard effective April 1, 2019.

IFRS 16, Leases

IFRS 16, which replaces IAS 17, represents a major revision of the way in which companies account for leases. It sets out the principles that both parties to a contract, i.e. the customer ("lessee") and the supplier ("lessor"), apply to provide relevant information about leases in a manner that faithfully represents those transactions. To meet this objective, a lessee is required to recognize assets and liabilities arising from a lease following a single model where previously leases were classified as either finance leases or operating leases. Most leases are recognized on the Corporation's consolidated balance sheet. Certain exemptions apply for short-term leases and leases of low-value assets.

The adoption of IFRS 16 had an impact on the consolidated balance sheet and statement of income as operating leases have been capitalized, corresponding lease liabilities have been recognized, rent expense has been replaced by the amortization expense of the right to use the related assets and the interest accretion expense from the liability recorded.

In addition, the principal repayments of lease liabilities are now presented as financing activities in the consolidated statements of cash flows, whereas under the previous standard these payments were presented as operating activities prior to April 1, 2019.

Right-of-Use Assets

Right-of-use assets are measured at cost. The cost is based on the initial amount of the lease liability plus initial direct costs incurred and estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located adjusted for any lease payments made at or before the commencement date, less any lease incentives received, if any.

The cost of right-of-use assets are periodically reduced by depreciation expenses and impairment losses, if any, and adjusted for certain remeasurement of the lease liability. Right-of-use assets are amortized to the lesser of the useful life or the lease term using the straight-line method as this reflects the expected pattern of consumption of the future economic benefits. The lease term includes the renewal option only if it is reasonably certain to exercise that option. Lease terms range from 1 to 20 years for buildings and 1 to 6 years for machinery, equipment and tooling.

Lease Liabilities

At the commencement date of the lease, the Corporation recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. Lease payments mainly include fixed payments less any lease incentives receivable and the exercise price of a purchase option reasonably certain to be exercised. Variable lease payments that do not depend on an index or a rate are recognized as an expense in the period during which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Corporation uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect accretion of interest and reduced for lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment of whether the underlying asset will be purchased.

Significant judgment in determining the lease term of contracts with renewal options

The Corporation determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised. After the commencement date, the Corporation reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

The Corporation has applied this standard using the modified retrospective approach (without restating comparative figures) for the fiscal year beginning April 1, 2019. Certain leases were not brought on the Corporation's consolidated balance sheet as they are covered by practical expedients. The Corporation has elected to apply the following practical expedients:

- Account for leases for which the remaining lease term ends within 12 months of the effective date as short-term leases; and
- Recognize short-term leases and low value leases on a straight-line basis as part of operating expenses in the consolidated statements of income.

The adoption of IFRS 16 had the following impacts on the consolidated statement of income:

Increase (decrease)	Quarter ended September 30, 2019	Six months ended September 30, 2019
Cost of sales, Selling and administrative expenses		
Depreciation and amortization	$ 775	$ 1,456
Other (rent expense)	(940)	(1,662)
Operating income	165	206
Financial expenses	348	574
Deferred income tax expense	(46)	(92)
Net income and comprehensive (loss) income	$ (137)	$ (276)

Increase (decrease)	As of April 1, 2019
Property, plant and equipment, net	$ 14,892
Long-term debt (1)	14,892

(1) The current portion of long-term debt impact correspond to $2,520 as at April 1, 2019

The following table presents the reconciliation between the operating leases commitments as of March 31, 2019 and the additional lease liabilities as of April 1, 2019:

Operating lease commitments as at March 31, 2019	$	16,823
Discounting operating leases as at April 1, 2019 [1]		(1,068)
Commitments relating to the change in the lease term assumptions and inclusion of non-lease components		1,002
Leases committed but not yet commenced as at April 1, 2019		(1,865)
Additional lease liabilities as at April 1, 2019	$	14,892
Pre-existing capital leases as at April 1, 2019		20,411
Total lease liabilities as at April 1, 2019	$	35,303

[1] At the date of adoption of IFRS 16, the weighted average incremental borrowing rate was 4.2%

The following tables reconciles the right-of-use assets for the Company as at September 30, 2019:

	Building and leasehold improvements	Machinery, equipment and tooling [1]	Other	Total
Cost:				
At April 1, 2019	$ 12,969	$ 41,368	$ 1,271	$ 55,608
Additions	6,498	—	111	6,609
Business acquisition	6,844	—	—	6,844
Effect of changes in exchange rates	246	15	150	411
As at September 30, 2019	$ 26,557	41,383	$ 1,532	$ 69,472
Accumulated amortization:				
At April 1, 2019	$ —	$ (10,006)	$ —	$ (10,006)
Amortization expense	(1,081)	(2,866)	(272)	(4,219)
Effect of changes in exchange rates	(7)	(1)	(14)	(22)
As at September 30, 2019	$ (1,088)	$ (12,873)	$ (286)	$ (14,247)
Net book value as at September 30, 2019	$ 25,469	$ 28,510	$ 1,246	$ 55,225

[1] Includes the pre-existing assets under capital leases (net book value of $30,710 as at April 1, 2019)

The following table presents the lease liabilities for the Company as at September 30, 2019:

	Lease liabilities
Balance at April 1, 2019	$ 35,303
Additions	6,609
Business acquisition	6,844
Lease payments	(4,298)
Interest expense on lease liabilities	855
Effect of changes in exchange rates	(1,099)
Balance as at September 30, 2019	$ 44,214

INTERNAL CONTROLS AND PROCEDURES

In compliance with the Canadian Securities Administrators' Regulation 52-109, the Corporation has filed certifications signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") that, among other things, report on disclosure controls and procedures and the design of internal controls over financial reporting.

The CEO and the CFO have designed disclosure controls and procedures, or have caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Corporation has been made known to them and has been properly disclosed in the interim and annual filings.

The CEO and CFO have also designed internal controls over financial reporting, or have caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

No changes were made to the Corporation's internal controls over financial reporting during the six-month period ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.

As permitted by the Canadian Securities Administrators' Regulation 52-109, management's assessment and conclusion on the design of disclosure controls and procedures and internal controls over financial reporting excludes the controls, policies and procedures of CESA, which was acquired on October 1, 2018. CESA's results are included in the September 30, 2019 interim condensed consolidated financial statements of Héroux-Devtek and constituted approximately 26.9% of total assets as at September 30, 2019 and 19.8% of total revenues for the six-month period ended September 30, 2019. Management expects that CESA business acquisition will be included in management's assessment and certification on the design of DCP and effectiveness ICFR in the third quarter of this fiscal year.

SELECTED QUARTERLY FINANCIAL INFORMATION

Fiscal year	2020		2019				2018	
	Second Quarter	First Quarter	Fourth quarter	Third Quarter	Second Quarter	First Quarter	Fourth quarter	Third quarter
Sales	$ 145,516	$ 143,427	$ 157,914	$ 144,528	$ 95,665	$ 85,770	$ 113,024	$ 97,006
Operating income	10,519	10,371	15,190	11,904	5,289	4,857	6,697	6,629
Adjusted operating income (1)	10,519	10,986	16,208	13,973	6,165	5,217	12,089	7,238
Adjusted EBITDA (1)	21,510	21,509	25,910	22,883	13,176	12,244	19,369	13,563
Net Income	6,307	6,443	11,958	7,390	3,294	3,552	5,858	626
Adjusted Net Income (1)	6,307	6,959	12,794	9,367	4,405	3,786	10,439	5,690
In dollars per share								
Earnings per share - Basic & Diluted	$ 0.18	$ 0.18	$ 0.34	$ 0.20	$ 0.09	$ 0.10	$ 0.16	$ 0.02
Adjusted earnings per share (1)	0.18	0.19	0.36	0.26	0.12	0.10	0.29	0.16
In millions of shares								
Weighted-average number of common diluted shares outstanding	36.7	36.6	36.5	36.4	36.5	36.4	36.4	36.4
Backlog (in million)	$ 769	$ 747	$ 624	$ 629	$ 479	$ 454	$ 466	$ 475

(1) *Non-IFRS financial measure. Refer to the* Non-IFRS financial measures *section under* Operating Results *for definitions and reconciliations to the most comparable IFRS measures.*

Seasonal trends

Héroux-Devtek's first semester is usually slower than the last one due to seasonality such as plant shutdowns and summer vacations.

RISKS AND UNCERTAINTIES

Héroux-Devtek operates in industry sectors that have a variety of risk factors and uncertainties. Risk and uncertainties that could materially affect the Corporation's business, financial condition and results of operations in an adverse manner are described in the Corporation's MD&A for the fiscal year ended March 31, 2019. Additional risks and uncertainties not presently known to the Corporation or that the Corporation currently believes to be immaterial may also adversely affect its business.

GUIDANCE[1]

Metric	Initial fiscal 2020 guidance	Updated Fiscal 2020 guidance
Fiscal 2020 sales	Sales of $560 to $580 million	Sales of $580 to $600 million
Long-term sales growth	Fiscal 2022 sales of $620 to $650 million	Fiscal 2022 sales of $650 to $680 million

(1) *Refer to* Forward-Looking Statements *in* Overview *for further information regarding forward-looking statements and related risks.*

In August 2019, included in the first quarter reporting, Management provided updated fiscal 2020 sales guidance as well as long-term sales growth guidance in order to reflect the expected contributions of Alta Précision to Héroux-Devtek's performance.

Management has prepared the foregoing guidance using the best information available upon preparing this MD&A, and based it on assumptions and sources of information including, but not limited to:

- Héroux-Devtek's backlog, long-term sales contracts and estimated future order intake, including those of Alta Précision but no other material acquisition;
- Existing OEM backlogs, production rates and disclosed production and delivery expectations;
- Stability of government defence budget, spending climates, trends and expectations;
- Stability of overall economic conditions;
- Stability of foreign exchange rates;
- The Corporation's ability to deliver on key contract initiatives; and,
- The successful deployment of integration and cross-selling initiatives.

Refer to the *Risk Management* section of the Corporation's MD&A for the fiscal year ended March 31, 2019 for discussion of certain other factors which may cause future results to differ from this guidance.

SHAREHOLDER INFORMATION

Expected issuance date of financial results	
Fiscal 2020	
Third quarter	February 6, 2020
Fourth quarter	May 21, 2020
Fiscal 2021	
First quarter	August 11, 2020
Second quarter	November 13, 2020

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