



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

QUARTERLY REPORT — FIRST QUARTER ENDED JUNE 30, 2013





## **MESSAGE TO SHAREHOLDERS**

### **First quarter ended June 30, 2013**

On behalf of the Board of Directors, I am pleased to present the financial results for Héroux-Devtek's first quarter ended June 30, 2013.

As anticipated, first-quarter results produced a solid increase in commercial product sales driven by the strength of the large commercial aircraft market. Meanwhile, lower military sales reflect the weaker U.S. military market, as evidenced by the reduced U.S. funding base defense budget and the persistent sequestration situation.

Consolidated sales from continuing operations reached \$63.0 million, down slightly from \$63.8 million in the first quarter of fiscal 2013. Fluctuations in the value of the Canadian currency versus the US currency reduced first-quarter sales by \$0.3 million compared with last year's first quarter. Sales to the commercial aerospace market increased 7.4% to \$28.2 million resulting from new actuator business with Boeing on the B-777 program and production ramp-up on the B-787 program. Sales to the military aerospace market declined 7.3% to \$34.7 million as a result of lower customer requirements for repair and overhaul services and spare parts, as well as lower electronic enclosure and cabinet sales at the Magtron operations, partially offset by new business with Boeing on the H-47 Chinook helicopter program.

Earnings before interest, taxes, depreciation and amortization ("EBITDA") from continuing operations amounted to \$7.7 million, or 12.3% of sales, compared with \$8.3 million, or 13.0% of sales, last year. The decrease reflects an unfavorable military aftermarket sales product mix, combined with certain non-recurring costs incurred in the development of a new landing gear system program. These factors were partially offset by a reduction in non-quality costs and lower year-over-year selling and administrative expenses resulting from a higher gain on currency translation and a reduction in professional fees related to certain projects last year.

Net income from continuing operations was \$2.8 million, or \$0.09 per diluted share, in the first quarter of fiscal 2014, relatively stable compared with \$2.9 million, or \$0.10 per diluted share, in the first quarter of fiscal 2013.

As at June 30, 2013, Héroux-Devtek's balance sheet remained healthy with cash and cash equivalents of \$96.7 million, or \$3.07 per share. At that same date, total debt was \$63.0 million, including \$23.1 million drawn against the Corporation's authorized Credit Facility of \$150.0 million, but excluding net deferred financing costs. As a result, the Corporation's net cash position stood at \$33.7 million as at June 30, 2013.

As at June 30, 2013, Héroux-Devtek's funded (firm orders) backlog stood at \$368 million, up from \$361 million at the end of the previous quarter, and remains well diversified.

Conditions remain favourable in the commercial aerospace market. Large commercial aircraft manufacturers continue to increase production rates for certain leading programs and are forecasting higher deliveries in calendar 2013 than a year earlier. Their backlogs remain strong, representing seven to eight years of production at current rates. In the business jet market, indicators point to a recovery and shipments should experience sustained growth in the next few years driven by a better economy and the introduction of several new aircraft, including three models for which Héroux-Devtek is currently developing the landing gear. The military aerospace market is expected to remain difficult. If sequestration in the U.S. is not reversed, the Corporation may be affected by U.S. defense cutbacks beyond the fiscal year ending March 31, 2014, despite having a diversified military portfolio,

balanced between new component manufacturing and aftermarket products and services, that should lessen this impact.

Despite the U.S. military spending cutbacks and the persistent sequestration, current trends in our main markets continue to point towards a marginal internal sales growth for the fiscal year ending March 31, 2014, assuming a stable currency environment. With respect to the second quarter, it is important to remember that it has traditionally been a relatively slower period owing to seasonal factors, such as plant shutdowns and summer vacations. Supported by a strong balance sheet, Héroux-Devtek actively remains on the lookout for business opportunities, both internally and through strategic acquisitions, that will enhance its value-added product and service offering and create further value for its shareholders.

Gilles Labbé  
President and Chief Executive Officer  
August 1, 2013



## **INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**First quarter ended June 30, 2013**

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

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

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

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

August 1, 2013.

**CONSOLIDATED BALANCE SHEETS**

As at June 30, 2013 and March 31, 2013

(In thousands of Canadian dollars) (Unaudited)

	Notes	June 30, 2013	March 31, 2013
<b>Assets</b>	12		
<b>Current assets</b>			
Cash and cash equivalents	9	\$ 96,696	\$ 101,256
Accounts receivable		39,935	46,550
Income tax receivable		645	858
Inventories		102,345	100,817
Derivative financial instruments	10	1,485	2,935
Other current assets	11	12,814	12,577
		253,920	264,993
<b>Property, plant and equipment, net</b>	5	77,785	78,186
<b>Finite-life intangible assets, net</b>	5	29,344	26,472
<b>Derivative financial instruments</b>	10	9	284
<b>Goodwill</b>		19,368	19,180
<b>Total assets</b>		\$ 380,426	\$ 389,115
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 39,948	\$ 44,302
Accounts payable - other		1,347	2,378
Provisions		9,415	8,901
Progress billings		7,290	10,211
Income tax payable		137	2,549
Derivative financial instruments	10	2,976	1,655
Current portion of long-term debt	12	3,466	3,808
		64,579	73,804
<b>Long-term debt</b>	12	58,328	59,149
<b>Provisions</b>		4,662	5,071
<b>Progress billings</b>		1,592	2,068
<b>Derivative financial instruments</b>	10	2,202	909
<b>Deferred income tax liabilities</b>		11,761	12,425
<b>Other liabilities – Pension and other retirement benefit plans</b>		11,670	13,036
		154,794	166,462
<b>Shareholders' equity</b>			
Issued capital	13	25,432	25,365
Contributed surplus	13	1,258	1,222
Accumulated other comprehensive income	14	2,851	2,647
Retained earnings		196,091	193,419
		225,632	222,653
		\$ 380,426	\$ 389,115

Discontinued operations and Commitments (notes 4 and 16)

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

**CONSOLIDATED STATEMENTS OF INCOME**

For the quarters ended June 30, 2013 and 2012

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

	Notes	2013	2012
			(Restated - note 3)
Continuing operations	4		
Sales		\$ 62,972	\$ 63,780
Cost of sales	5, 6	53,820	53,283
Gross profit		9,152	10,497
Selling and administrative expenses	6	4,641	5,466
Operating income		4,511	5,031
Financial expenses	7	723	1,122
Income before income tax expense from continuing operations		3,788	3,909
Income tax expense		974	963
Net income from continuing operations		2,814	2,946
Discontinued operations	4	—	3,258
Net income		\$ 2,814	\$ 6,204
Earnings per share from continuing operations – basic	8	\$ 0.09	\$ 0.10
Earnings per share from continuing operations – diluted	8	\$ 0.09	\$ 0.10
Earnings per share – basic	8	\$ 0.09	\$ 0.20
Earnings per share – diluted	8	\$ 0.09	\$ 0.20

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

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

For the quarters ended June 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

	Notes	2013	2012
	14		(Restated - note 3)
Other comprehensive income from continuing operations:			
Items that may be reclassified to net income			
Gain arising from translating the financial statements of foreign operations	\$	3,793	\$ 707
Cash flow hedges:			
Net losses on valuation of derivative financial instruments		(3,435)	(1,384)
Net gains on derivative financial instruments transferred to net income		(520)	(2,049)
Deferred income taxes		1,052	900
		(2,903)	(2,533)
Losses on hedge of net investments in U.S. operations		(788)	(452)
Deferred income taxes		102	60
		(686)	(392)
Items that are never reclassified to net income			
Defined benefit pension plans:			
Actuarial losses		(194)	(1,898)
Deferred income taxes		52	506
		(142)	(1,392)
Other comprehensive income (loss) from continuing operations		62	(3,610)
Discontinued operations	4	—	1,199
Other comprehensive income (loss)	\$	62	\$ (2,411)
Comprehensive income			
Continuing operations:			
Net income	\$	2,814	\$ 2,946
Other comprehensive income (loss)		62	(3,610)
Comprehensive income (loss) from continuing operations		2,876	(664)
Discontinued operations:			
Net income	4	—	3,258
Other comprehensive income	4	—	1,199
Comprehensive income from discontinued operations		—	4,457
Comprehensive income	\$	2,876	\$ 3,793

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

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

For the quarters ended June 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

	Notes	Issued capital	Contributed surplus	Accumulated other comprehensive income	Retained earnings	Shareholders' equity
<b>Balance as at March 31, 2013</b>		\$ 25,365	\$ 1,222	\$ 2,647	\$ 193,419	\$ 222,653
Common shares issued under the Stock purchase and ownership incentive plan	13	67	—	—	—	67
Stock-based compensation expense	13	—	36	—	—	36
Net income		—	—	—	2,814	2,814
Other comprehensive income (loss)		—	—	204	(142)	62
<b>Balance as at June 30, 2013</b>		\$ 25,432	\$ 1,258	\$ 2,851	\$ 196,091	\$ 225,632

	Notes	Issued capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings	Shareholders' equity
<b>Balance as at March 31, 2012</b>		\$ 102,202	\$ 3,059	\$ 2,515	\$ 136,191	\$ 243,967
Common shares issued under the Stock purchase and ownership incentive plan	13	85	—	—	—	85
Stock-based compensation expense	13	—	115	—	—	115
Net income <sup>(1)</sup>		—	—	—	6,204	6,204
Other comprehensive income (loss) <sup>(1)</sup>		—	—	(1,019)	(1,392)	(2,411)
<b>Balance as at June 30, 2012</b>		\$ 102,287	\$ 3,174	\$ 1,496	\$ 141,003	\$ 247,960

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

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the quarters ended June 30, 2013 and 2012

(In thousands of Canadian dollars) (Unaudited)

	Notes	2013	2012
			(Restated - note 3)
<b>Cash and cash equivalents provided by (used for):</b>			
<b>Operating activities</b>			
Net income from continuing operations		\$ 2,814	\$ 2,946
Items not requiring an outlay of cash:			
Amortization expense	6	3,236	3,240
Deferred income tax		623	(107)
Loss (gain) on sale of property, plant and equipment		1	(17)
Amortization of deferred financing costs	7	110	110
Interest accretion expense and discount rate adjustments	7	332	702
Stock-based compensation expense	13	36	115
Cash flows from continuing operations		7,152	6,989
Net change in non-cash items related to continuing operations	15	(4,112)	(4,033)
<b>Cash flows related to operating activities from continuing operations</b>		<b>3,040</b>	<b>2,956</b>
Cash flows related to operating activities from discontinued operations		(1,641)	8,948
<b>Cash flows related to operating activities</b>		<b>1,399</b>	<b>11,904</b>
<b>Investing activities</b>			
Additions to property, plant and equipment		(3,181)	(3,471)
Net increase in finite-life intangible assets		(2,995)	(3,108)
Proceeds on disposal of property, plant and equipment		—	4
Cash flows related to investing activities of discontinued operations		—	(1,375)
<b>Cash flows related to investing activities</b>		<b>(6,176)</b>	<b>(7,950)</b>
<b>Financing activities</b>			
Repayment of long-term debt		(2,561)	(2,723)
Issuance of common shares	13	67	85
Cash flows related to financing activities of discontinued operations		—	(1,687)
<b>Cash flows related to financing activities</b>		<b>(2,494)</b>	<b>(4,325)</b>
<b>Effect of changes in exchange rates on cash and cash equivalents</b>		<b>2,711</b>	<b>862</b>
<b>Change in cash and cash equivalents during the periods</b>		<b>(4,560)</b>	<b>491</b>
<b>Cash and cash equivalents at beginning of periods</b>		<b>101,256</b>	<b>62,007</b>
<b>Cash and cash equivalents at end of periods</b>		<b>\$ 96,696</b>	<b>\$ 62,498</b>
<b>Interest and taxes reflected in operating activities:</b>			
Interest paid for continuing operations		\$ 391	\$ 344
Interest received from continuing operations		\$ 110	\$ 34
Income taxes paid for continuing operations		\$ 661	\$ 2,638
Interest paid for discontinued operations		\$ —	\$ 652
Income taxes paid (recovered) for discontinued operations		\$ 1,641	\$ (236)

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

## NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the quarters ended June 30, 2013 and 2012

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

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

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

### Note 2. Basis of preparation

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

These interim condensed consolidated financial statements were approved for issue by the Board of Directors of the Corporation on July 31, 2013.

Comparative figures for the interim condensed consolidated financial statements for the period ended June 30, 2012 have been reclassified to conform to the presentation adopted for the period ended June 30, 2013.

### Note 3. Changes in accounting policies

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

#### IAS 1 *Financial Statement Presentation*

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

#### IFRS 13 *Fair Value Measurements*

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

#### IAS 19 *Employee Benefits*

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

The impact of the adoption of the amended IAS 19, *Employee Benefits* on the consolidated statement of income and consolidated statement of comprehensive income for the quarter ended June 30, 2012 is as follows:

• Decrease of cost of sales	\$	(18)
• Increase of financial expenses		126
• Decrease of income tax expense		(29)
• Decrease of net income from continuing operations and net income		(79)
• Decrease of actuarial losses, net of income taxes		79
• Increase of other comprehensive income from continuing operations and other comprehensive income		79

#### Note 4. Discontinued operations

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

The sale transaction was concluded on August 31, 2012 with gross sale proceeds, including post-closing adjustments, of \$297.8 million paid in cash. Taking into consideration the related taxes and transaction related costs, the net proceeds amounted to \$234.3 million. The gain of \$163.0 million on the sale transaction, net of the related taxes of \$51.8 million, amounted to \$111.2 million.

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

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

Net income related to the discontinued operations for the quarter ended June 30, 2012, is presented as follows:

Sales	\$	35,447
Cost of sales		28,508
Gross profit		6,939
Selling and administrative expenses		1,953
Operating income		4,986
Financial expenses		636
Income before income tax expense from discontinued operations		4,350
Income tax expense related to discontinued operations		1,092
Net income from discontinued operations	\$	3,258
Earnings per share from discontinued operations - basic	\$	0.10
Earnings per share from discontinued operations - diluted	\$	0.10

Comprehensive income related to the discontinued operations for the quarter ended June 30, 2012, are presented as follows:

Other comprehensive income:	
Items that may be reclassified to net income	
Gain arising from translating the financial statements of foreign operations	\$ 2,036
Cash flow hedges:	
Net gains on valuation of derivative financial instruments	1,354
Net gains on derivative financial instruments transferred to net income	(1,570)
Deferred income taxes	53
	(163)
Losses on hedge of net investments in U.S. operations	(772)
Deferred income taxes	98
	(674)
Other comprehensive income from discontinued operations	1,199
Net income from discontinued operations	3,258
Comprehensive income from discontinued operations	\$ 4,457

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

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

#### Note 5. Government assistance

During the quarter ended June 30, 2013, the Corporation recorded as government assistance an amount of \$460 as a reduction of cost of sales (\$554 in 2012) and an amount of \$310 (\$373 in 2012) as a reduction of the related property, plant and equipment or capitalized development costs, presented under Finite-life intangible assets.

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

The main components of these expenses for the quarters ended June 30, are as follows:

	2013	2012
		(Restated - note 3)
Raw materials and purchased parts	\$ 25,163	\$ 23,568
Employee costs	24,038	24,506
Amortization of property, plant and equipment and finite-life intangible assets	3,236	3,240
Others	6,024	7,435
	\$ 58,461	\$ 58,749

Foreign exchange gains or losses resulting from the translation of net monetary items denominated in foreign currencies are included in the Corporation's selling and administrative expenses. During the quarter ended June 30, 2013, the foreign exchange gain included in the Corporation's selling and administrative expenses amounted to \$520 (\$26 in 2012).

## Note 7. Financial expenses

Financial expenses for the quarters ended June 30, comprise the following:

	2013	2012
		(Restated - note 3)
Interest expense	\$ 252	\$ 240
Interest accretion on governmental authorities loans	469	447
Interest on net defined benefit obligations	114	126
Amortization of deferred financing costs (note 12)	110	110
Standby fees	139	104
Other interest accretion expense and discount rate adjustments	(251)	129
	833	1,156
Gain on financial instruments classified as FVTPL <sup>(1)</sup> – Interest income	110	34
	\$ 723	\$ 1,122

(1) Fair value through profit or loss.

## Note 8. Earnings per share

The following table sets forth the elements used to compute basic and diluted earnings per share for the quarters ended June 30:

	2013	2012
Weighted-average number of common shares outstanding	31,517,146	30,448,869
Effect of dilutive stock options of the Corporation	151,496	368,772
Weighted-average number of common diluted shares outstanding	31,668,642	30,817,641

The diluted earnings per share calculation does not take into consideration the potential dilutive effect of certain stock options of the Corporation since their impact is anti-dilutive. During the quarter ended June 30, 2013, no stock options of the Corporation's plan (335,000 in 2012) were excluded from the diluted earnings per share calculation.

## Note 9. Cash and cash equivalents

	June 30, 2013	March 31, 2013
Cash at banks	\$ 86,644	\$ 91,236
Short-term deposits	10,052	10,020
	\$ 96,696	\$ 101,256

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

## Note 10. Derivative financial instruments

### Forward foreign exchange contracts

As at June 30, 2013, the Corporation had forward foreign exchange contracts to sell US\$120.0 million at a weighted-average rate of 1.0326 (Canadian dollar over U.S. dollar, "cad/usd"). As at March 31, 2013 and June 30, 2012, these contracts totalled US\$123.5 million at a weighted-average rate of 1.0325 cad/usd and US\$147.7 million at a weighted-average rate of 1.0561 cad/usd, respectively. As at June 30, 2013, these contracts mature at various dates between July 2013 and March 2017, with the majority maturing this and next fiscal year.

As at June 30, 2013 and March 31, 2013, the Corporation had also entered into forward foreign exchange contracts to sell US\$3.3 million at a weighted-average rate of 1.2262 cad/usd and US\$4.7 million at a weighted-average rate of 1.2262 cad/usd, respectively. These contracts cover foreign exchange risk related to certain embedded derivative financial instruments and they all mature this fiscal year.

### Interest rate swap agreements

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

As at June 30, 2012, the Corporation had entered into three interest rate swap agreements for a total notional amount of US\$40 million, which fix the Libor rate at 3.90% for an amount of US\$20 million and at 3.91% for amounts totalling US\$20 million, and were maturing in December 2015.

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

### Note 11. Other current assets

	June 30, 2013	March 31, 2013
Investment and other tax credits receivable	\$ 8,742	\$ 9,051
Sales tax receivable	1,266	1,405
Deposits on machinery and equipment (note 16)	701	234
Prepaid expenses	1,634	1,540
Others	471	347
	<b>\$ 12,814</b>	<b>\$ 12,577</b>

### Note 12. Long-term debt

	June 30, 2013	March 31, 2013
Senior Secured Syndicated Revolving Credit Facility ("Credit Facility") of up to \$150,000 - either in Canadian or U.S. currency equivalent, maturing on March 15, 2016, which bears interest at Libor plus 1.875% representing an effective interest rate of 2.1% as at June 30, 2013 and March 31, 2013, secured by all assets of the Corporation and its subsidiaries. The Credit Facility includes an accordion feature to increase the Credit Facility up to \$225 million subject to lenders' consent. As at June 30, 2013 and March 31, 2013, the Corporation used US\$22,000 on the Credit Facility.	\$ 23,140	\$ 22,352
Governmental authorities loans, repayable in variable annual instalments, with various expiry dates until fiscal year 2030.	34,685	36,101
Obligations under finance leases, all bearing fixed interest rates between 3.3% and 6.5% as at June 30, 2013 and March 31, 2013, maturing from January 2016 to July 2019, with amortization periods ranging from five to seven years, secured by the related property, plant and equipment, net of interest of \$472 (\$542 as at March 31, 2013).	5,072	5,420
Promissory note, repayable in monthly instalments over 40 months up to July 2013, bearing fixed interest at 5% and guaranteed by the Corporation.	105	402
Deferred financing costs, net	(1,208)	(1,318)
	<b>61,794</b>	<b>62,957</b>
Less: current portion	3,466	3,808
	<b>\$ 58,328</b>	<b>\$ 59,149</b>

### Note 13. Issued capital

For the quarter ended June 30, 2013, variations in common shares issued are as follows:

	June 30, 2013	
	Number	Issued capital
<b>Common shares issued and fully paid</b>		
Opening balance	31,511,446	\$ 25,365
Issued for cash under the stock purchase and ownership incentive plan	9,336	67
<b>Closing balance</b>	<b>31,520,782</b>	<b>\$ 25,432</b>

#### Issuance of common shares

During the quarter ended June 30, 2013, the Corporation issued 9,336 common shares at a weighted-average price of \$7.14 under the Corporation's stock purchase and ownership incentive plan for a total cash consideration of \$67.

During the quarter ended June 30, 2012, the Corporation issued 11,093 common shares at a weighted-average price of \$7.63 under the Corporation's stock purchase and ownership incentive plan for a total cash consideration of \$85.

#### A. Stock option plan

During the quarters ended June 30, 2013 and 2012, no stock options were granted, exercised or cancelled. As at June 30, 2013 and March 31, 2013, 259,101 stock options were issued and outstanding at a weighted-average exercise price of \$3.30.

For the quarter ended June 30, 2013, the stock option expense amounted to \$36 (\$115 in 2012).

#### B. Stock purchase and ownership incentive plan

During the quarter ended June 30, 2013, 9,336 common shares were issued (11,093 in 2012) and 3,834 common shares were attributed to the participating employees (4,577 in 2012), under the stock purchase and ownership incentive plan. For the quarter ended June 30, 2013, the expense related to the attributed common shares amounted to \$31 (\$38 in 2012).

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

During the quarters ended June 30, 2013 and 2012, no SARs were exercised or cancelled. As at June 30, 2013 and March 31, 2013, on a cumulative basis, 39,000 SARs were still outstanding at a weighted-average granted value of \$2.78 which expire on various dates from fiscal 2014 to 2016.

For the quarter ended June 30, 2013, SAR expense amounted to \$21 (reversal of expense of \$110 in 2012).

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

#### D. DSU plan

During the quarters ended June 30, 2013 and 2012, no DSUs were issued, exercised or cancelled. As at June 30, 2013 and March 31, 2013, on a cumulative basis, 75,302 DSUs were outstanding.

For the quarter ended June 30, 2013, DSU expense amounted to \$58 (reversal of expense of \$14 in 2012).

**Note 14. Accumulated other comprehensive income**

Changes in accumulated other comprehensive income are as follows:

	Exchange differences on translation of foreign operations	Cash flow hedges	Hedge of net investments in U.S. operations	Total
<b>Balance as at March 31, 2013</b>	\$ 3,215	\$ 63	\$ (631)	\$ 2,647
Other comprehensive income (loss) from continuing operations	3,793	(2,903)	(686)	204
<b>Balance as at June 30, 2013</b>	\$ 7,008	\$ (2,840)	\$ (1,317)	\$ 2,851
<b>Balance as at March 31, 2012</b>	\$ (771)	\$ 4,038	\$ (752)	\$ 2,515
Other comprehensive income (loss) from continuing operations	707	(2,533)	(392)	(2,218)
Other comprehensive income (loss) from discontinued operations (note 4)	2,036	(163)	(674)	1,199
<b>Balance as at June 30, 2012</b>	\$ 1,972	\$ 1,342	\$ (1,818)	\$ 1,496

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

For the quarters ended June 30, the net change in non-cash items related to continuing operations is detailed as follows:

	2013	2012
Accounts receivable	\$ 6,615	\$ 2,802
Income tax receivable	233	—
Inventories	(1,528)	(3,443)
Other current assets	(1)	60
Accounts payable and accrued liabilities, and other liabilities	(5,887)	1,228
Accounts payable - other	(121)	—
Provisions	105	(114)
Progress billings	(3,397)	(2,904)
Income tax payable	(791)	(2,150)
Effect of changes in exchange rate <sup>(1)</sup>	660	488
	\$ (4,112)	\$ (4,033)

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

**Note 16. Commitments**

The Corporation has released purchase orders relating to machinery and equipment which have not been delivered yet to the Corporation's facilities. As at June 30, 2013, these outstanding purchase orders amounted to \$3,428 (\$2,391 as at March 31, 2013) for which an amount of \$701 (\$234 as at March 31, 2013) in deposits on machinery and equipment were made and are included in the Corporation's other current assets.

## Note 17. Segment information

### Geographic information

For the quarters ended June 30, geographic information related to the continuing operations represents the following:

	2013			2012		
	Canada	U.S.	Total	Canada	U.S.	Total
Continuing operations						
Sales	\$ 50,521	\$ 12,451	\$ 62,972	\$ 51,581	\$ 12,199	\$ 63,780
Property, plant and equipment, net	65,254	12,531	77,785	64,482	13,114	77,596
Finite-life intangible assets, net	29,048	296	29,344	24,398	505	24,903
Goodwill	13,838	5,530	19,368	13,838	5,353	19,191
Export sales <sup>(1)</sup>	\$ 30,273			\$ 33,930		

During the quarters ended June 30, 2013 and 2012, 63% and 68% of the Corporation's sales respectively were made to U.S. customers.

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



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

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

MANAGEMENT DISCUSSION AND ANALYSIS  
OF FINANCIAL POSITION AND OPERATING RESULTS

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

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

This analysis should be read in conjunction with the Corporation's unaudited interim condensed consolidated financial statements for the quarters ended June 30, 2013 and 2012, and the audited consolidated financial statements and MD&A for the fiscal year ended March 31, 2013, all of which are available on the Corporation's website at [www.herouxdevtek.com](http://www.herouxdevtek.com). This MD&A is based on our unaudited interim condensed consolidated financial statements prepared in accordance with IAS 34, Interim Financial Reporting, using the Canadian dollar as the reporting currency. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

### Non-IFRS Measures

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

The Corporation's EBITDA from continuing operations is calculated as follows:

(\$'000)	<u>Quarters ended</u>	
	<u>June 30</u>	
	<u>2013</u>	<u>2012</u>
Net income from continuing operations	2,814	2,946
Income tax expense	974	963
Financial expenses	723	1,122
Amortization expense	3,236	3,240
<b>EBITDA</b>	<b>7,747</b>	<b>8,271</b>

For the first quarter ended June 30, 2013, the lower EBITDA reflects a lower operating income realized this quarter, when compared to last year, as explained in the following sections.

### Forward-Looking Statements

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

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

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

## **Overview**

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

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

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

## **Discontinued operations**

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

The sale transaction was concluded on August 31, 2012 with gross sale proceeds, including post-closing adjustments, of \$297.8 million paid in cash. Taking into consideration the related taxes and transaction related costs, the net proceeds amounted to \$234.3 million. The gain of \$163.0 million on the sale transaction, net of the related taxes of \$51.8 million, amounted to \$111.2 million.

Last year, concurrently to the sale transaction, the Corporation proceeded with a \$16.0 million reduction of finance lease obligations and the repayment of a \$1.0 million governmental authorities' loan related to the businesses sold. The Corporation also proceeded with a partial repayment of US\$37.5 million (\$37.0 million) against the Syndicated Banks' Credit Facility ("Credit Facility") and repurchased two of the three interest rate swap agreements in place, representing a total notional amount of US\$30.0 million, for a total cost of \$1.7 million which was recorded as transaction related costs to the sale transaction.

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

## **RESULTS OF OPERATIONS**

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

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

## Foreign Exchange

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

<b>Canada / US Exchange Rates</b>	<b>June 30, 2013</b>	<b>June 30, 2012</b>
Average rate for quarters ended	<u>1.0233</u>	<u>1.0102</u>

  

<b>Canada / US Exchange Rates</b>	<b>June 30, 2013</b>	<b>March 31, 2013</b>
Closing rates	<u>1.0518</u>	<u>1.0160</u>

As shown above, the average value of the Canadian dollar for the quarter ended June 30, 2013, was 1.3% lower, when compared to its U.S. counterpart, year-over-year, and had a positive impact on the U.S.-denominated sales and results of the Corporation, exclusive of FFEC fluctuations, including those from its Canadian operations. The variation in the closing rate since March 31, 2013 had a favorable impact on the Corporation’s U.S.-denominated balance sheet accounts at the end of this quarter, when compared to last year-end balances. Currency fluctuation impact on the Corporation’s sales, gross profit and specific balance sheet elements can be found later in this MD&A.

The Corporation makes use of derivative financial instruments, in accordance with its hedging policy, to hedge foreign currency fluctuation exposure risks (Canadian dollar over US dollar) in an effort to mitigate these risks. As at June 30, 2013, the Corporation had FFEC to sell US\$120.0 million at a weighted-average rate of 1.0326 maturing at various dates between July 2013 and March 2017, with the majority maturing this and next fiscal years.

As at June 30, 2013, the Corporation had also entered into FFEC to sell US\$3.3 million at a weighted-average rate of 1.2262 all maturing this fiscal year, to cover foreign exchange risks (Canadian dollar over US dollar) related to certain embedded derivatives.

## Consolidated Sales

Consolidated sales for the first quarter ended June 30, 2013 decreased by \$0.8 million or 1.3% to \$63.0 million from \$63.8 million last year. This is the result of lower aftermarket military sales,

partially offset by increased sales of \$1.9 million or 7.4% in the commercial sector, essentially resulting from higher sales on the B-777 and B-787 programs. Exchange fluctuations also reduced sales by \$0.3 million or 0.4%, when compared to last year.

Sales can be broken down by sector as follows:

	<b>Quarters ended</b>			
	<b>June 30</b>			
	<b>2013</b>	<b>2012</b>	<b>Variance</b>	
	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>(\$'000)</b>	<b>%</b>
Military <sup>(1)</sup>	<b>34,732</b>	37,478	(2,746)	(7.3)
Commercial	<b>28,240</b>	26,302	1,938	7.4
<b>Total</b>	<b>62,972</b>	<b>63,780</b>	<b>(808)</b>	<b>(1.3)</b>

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

Military sales were \$2.7 million or 7.3% lower this quarter to \$34.7 million from \$37.5 million last year. The decrease in sales is essentially the result of lower repair and overhaul sales, resulting from lower customer requirements, combined with lower customer demand for spares on the B-2, C-17 and F-15 programs, partially offset by new business with The Boeing Company (“Boeing”) on the CH-47 helicopter program. The decrease in military sales is also the result of lower electronic enclosure and cabinet sales at the Magtron operations. The lower military sales reflect the weaker U.S. military market, as evidenced by the reduced funding of the U.S. base defense budget and the continued sequestration situation.

Commercial sales were \$1.9 million or 7.4% higher this quarter to \$28.2 million from \$26.3 million last year. This increase is the result of higher sales on large commercial programs, essentially resulting from new actuator business with Boeing on the B-777 program and production ramp-up on the B-787 program.

#### *Sales by Destination*

The Corporation’s sales by destination were as follows:

	<b>Quarters ended</b>	
	<b>June 30</b>	
	<b>2013</b>	<b>2012</b>
	<b>(%)</b>	<b>(%)</b>
Canada	<b>33</b>	28
US	<b>63</b>	68
International	<b>4</b>	4
<b>Total</b>	<b>100</b>	<b>100</b>

The change in the sales by destination mix mainly reflects the impact of increased large commercial sales delivered in Canada, combined with lower aftermarket military sales in the U.S.

## Gross Profit

This quarter, consolidated gross profit as a percentage of sales was 14.5%, a decrease of 2.0% from 16.5% last year.

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

This quarter, consolidated gross profit was impacted by an unfavorable military aftermarket sales product mix, combined with higher non-recurring costs incurred in the development of a new landing gear system program. These negative impacts on gross profit were partially offset by lower non-quality costs, when compared to last year.

## Selling and Administrative Expenses

Selling and administrative expenses were as follows:

	<u>Quarters ended</u> <u>June 30</u>	
	<b>2013</b>	<b>2012</b>
Selling and administrative expenses (\$'000)	<b>4,641</b>	5,466
% of sales	<b>7.4%</b>	8.6%

Selling and administrative expenses stood at \$4.6 million or 7.4% of sales for the quarter ended June 30, 2013, a decrease of \$0.8 million or 1.2% of sales from \$5.5 million or 8.6% of sales last year. This quarter, selling and administrative expenses include a gain on currency translation on net monetary items denominated in foreign currencies of \$0.5 million, compared to a negligible gain last year. The decrease in these expenses also reflects the lower professional fees incurred this year, compared to last year, for certain specific projects.

## Operating Income

Consolidated operating income stood at \$4.5 million or 7.2% of sales for the quarter ended June 30, 2013, compared to \$5.0 million or 7.9% of sales last year. The lower operating income in dollars and as a percentage of sales reflects the lower gross profit and selling and administrative expenses, as explained above.

## Financial Expenses

Financial expenses stood at \$0.7 million for the quarter ended June 30, 2013, while it stood at \$1.1 million last year. The lower financial expenses this quarter mainly results from a favorable discount rate adjustment of \$0.3 million recorded on the provision for asset retirement obligations reflecting the increase in the discount rate from March 31, 2013 to June 30, 2013. It also reflects higher interest income resulting from the increased cash position of the Corporation, following

last year's sale transaction net of the special distribution made to shareholders (see section below).

### Income Tax Expense

For the quarters ended June 30, 2013 and 2012, the income tax expense stood at \$1.0 million.

This quarter, the Corporation's effective income tax rate was 25.7%, compared to its Canadian blended statutory income tax rate of 26.7%. The effective income tax rate reflects the favourable impact from permanent differences (\$0.1 million) partially offset by the negative impact of a higher U.S. income tax rate for the Corporation's U.S. subsidiaries (\$0.1 million).

The Corporation's effective income tax rate for the same period last year was 24.6%, compared to its Canadian blended statutory income tax rate of 26.1%. The effective income tax rate reflects the favourable impact from permanent differences (\$0.2 million), partially offset by the negative impact of a higher U.S. income tax rate for the Corporation's U.S. subsidiaries (\$0.1 million).

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

### Net Income

For the quarter ended June 30, 2013, the Corporation posted a net income from continuing operations of \$2.8 million or 4.5% of sales, compared to \$2.9 million or 4.6% of sales for the same period last year.

Last year's net income also includes the net income from discontinued operations of \$3.3 million for the quarter ended June 30, 2012.

	<u>Quarters ended</u>	
	<u>June 30</u>	
	<b>2013</b>	<b>2012</b>
Net income from continuing operations (\$'000)	<b>2,814</b>	2,946
Net income from discontinued operations (\$'000)	-	3,258
Net income (\$'000)	<b>2,814</b>	6,204
Earnings per share from continuing operations – basic (\$)	<b>0.09</b>	0.10
Earnings per share from continuing operations – diluted (\$)	<b>0.09</b>	0.10
Earnings per share – basic (\$)	<b>0.09</b>	0.20
Earnings per share – diluted (\$)	<b>0.09</b>	0.20

Basic earnings per share figures are based on year-to-date weighted-averages of 31,517,146 common shares outstanding for the first quarter ended June 30, 2013 and 30,448,869 common shares for the same period last year, while the diluted earnings per share figures are based on year-to-date weighted-averages of 31,668,642 for this quarter and 30,817,641 last year. The

increase in the weighted-average number of outstanding common shares from June 30, 2012 to June 30, 2013 is mainly related to last fiscal year's issuance of 1,034,543 common shares under the Corporation's stock option plan.

On July 31, 2013, the date of this MD&A, the Corporation had 31,523,688 common shares and 259,101 stock options outstanding with a weighted-average of 3.6 years to maturity.

### **Other accumulated comprehensive income ("OACI") and comprehensive income**

For the first quarter ended June 30, 2013, the other comprehensive income, included in the comprehensive income from continuing operations, is mainly the result of a gain arising from translating the financial statements of foreign operations resulting from the appreciation of the US currency versus the Canadian currency, partially offset by net losses on valuation of derivative financial instruments and net gains on derivative financial instruments transferred to net income during the quarter, combined with net actuarial losses of the Corporation's defined benefit pension plans resulting from the negative impact of a lower than expected return on plan assets.

### **Liquidity and Capital Resources**

#### *Special Distribution to Shareholders*

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

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

#### *Credit Facility and Cash and Cash Equivalents*

In general terms, the Corporation has a healthy financial situation and is well positioned to face its financing needs for the current fiscal year. Taking into account the sale transaction on August 31, 2012 and the special distribution to shareholders on December 19, 2012, the Corporation had cash and cash equivalents of \$96.7 million as at June 30, 2013, compared to \$101.3 million at March 31, 2013, of which \$10.0 million had been invested in short-term deposits (\$10.0 million at March 31, 2013). The remaining cash and cash equivalents were held in investment accounts with three Canadian Banks and their U.S. affiliates or branches of the Corporation's syndicated banks.

The Corporation has in place a Senior Secured Syndicated Revolving Credit Facility with a syndicate of five Canadian Banks and their U.S. affiliates or branches, and a Canadian branch of a U.S. Bank. This Credit Facility allows the Corporation and its subsidiaries to borrow up to \$150 million, either in Canadian or US currency equivalent and will mature in March 2016. It also includes an accordion feature to increase the Credit Facility up to \$225 million, during the term of the Credit Agreement, subject to approval by the lenders. As at June 30, 2013, the Corporation only had \$23.1 million (US\$22.0 million) drawn against the Credit Facility compared to \$22.4 million as at March 31, 2013 (US\$22.0 million). Considering the Corporation's cash and cash equivalents position, its available Credit Facility and level of expected capital investments and results, the Corporation's management does not expect any significant liquidity risk in the foreseeable future.

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

	(\$'000)
Cash and cash equivalents	96,696
Less: Long-term debt, including current portion <sup>(1)</sup>	(63,002)
Net cash position	33,694

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

#### Operating Activities

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

	<u>Quarters ended</u>	
	<u>June 30</u>	
	2013 (\$'000)	2012 (\$'000)
Cash flows from continuing operations	7,152	6,989
Net change in non-cash items related to continuing operations	(4,112)	(4,033)
Cash flows related to operating activities from continuing operations	3,040	2,956
Cash flows related to operating activities from discontinued operations	(1,641)	8,948
Cash flows related to operating activities	1,399	11,904

The \$0.2 million increase in cash flows from continuing operations for the quarter ended June 30, 2013, when compared to last year's period, is mainly explained by a \$0.7 million higher deferred income tax expense, partially offset by a \$0.1 million lower net income and a \$0.3 million favorable discount rate adjustment.

This quarter, cash flows related to operating activities from discontinued operations includes the final payment of income taxes for the last fiscal year 2013.

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

	<b>Quarters ended</b>	
	<b><u>June 30</u></b>	
	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>
Accounts receivable	<b>6,615</b>	2,802
Inventories	<b>(1,528)</b>	(3,443)
Accounts payable and accrued liabilities, accounts payable-other, and other liabilities (referred to as "accounts payable")	<b>(6,008)</b>	1,228
Progress billings	<b>(3,397)</b>	(2,904)
Income taxes payable and receivable	<b>(558)</b>	(2,150)
All others	<b>764</b>	434
	<b>(4,112)</b>	<b>(4,033)</b>

For the first quarter ended June 30, 2013, the decrease in accounts receivable and accounts payable results from the lower sales volume this quarter, compared to last year's fourth quarter, which is historically the best quarter of the year, partially offset by the impact of a higher US/CAD foreign exchange closing rate used to convert the U.S.-denominated accounts receivable and accounts payable at period-end. This quarter, the increase in inventories mainly reflects the increased volume on the commercial programs, while the reduction in progress billings reflects a higher commercial funded backlog business mix, and a reduced backlog on certain military programs. The reduction in income taxes payable and receivable for the quarter ended June 30, 2013 mainly reflects the final payment of income taxes made for fiscal 2013.

For the first quarter ended June 30, 2012, the decrease in accounts receivable was mainly the result of a lower sales volume in last year's first quarter, compared to the previous year's fourth quarter, partially offset by the impact of a higher US/CAD foreign exchange closing rate used to convert the U.S.-denominated accounts receivable at period-end. Last year, the increase in inventories reflected the increased production rates in the commercial sector, while the reduction in progress billings mainly reflected a reduced backlog on certain military programs. The reduction in income taxes payable and receivable for the quarter ended June 30, 2012 mainly reflected the final payment of income taxes made for fiscal 2012.

### Investing Activities

The Corporation's investing activities were as follows:

	<b>Quarters ended</b>	
	<b>June 30</b>	
	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>
Additions to property, plant and equipment <sup>(1)</sup>	<b>(3,181)</b>	(3,471)
Net increase in finite-life intangible assets <sup>(1)</sup>	<b>(2,995)</b>	(3,108)
Proceeds on disposal of property, plant and equipment <sup>(1)</sup>	-	4
Investing activities of discontinued operations	-	(1,375)
Cash flows relating to investing activities	<b>(6,176)</b>	<b>(7,950)</b>

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

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

	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>
Additions to property, plant and equipment	<b>2,271</b>	2,195
Variation in unpaid additions included in Accounts payable – Other at period-end	<b>910</b>	1,276
Additions, as per statements of cash flows	<b>3,181</b>	<b>3,471</b>

This quarter, the additions to property, plant and equipment stood at \$2.3 million (\$2.2 million from continuing operations last year). It includes capital investments in the St-Hubert Engineering and Longueuil operations facilities to support certain aerospace development programs, along with maintenance capital expenditure requirements.

Capital expenditures for fiscal 2014 are expected to be about \$16.0 million, including \$3.0 million related to the Landing Gear USA operations and \$2.0 million for the engineering facility.

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

## Financing Activities

The Corporation's financing activities were as follows:

	<u>Quarters ended</u>	
	<u>June 30</u>	
	<b>2013</b>	<b>2012</b>
	<b>(\$'000)</b>	<b>(\$'000)</b>
Repayment of long-term debt	<b>(2,561)</b>	(2,723)
Issuance of common shares	<b>67</b>	85
Financing activities of discontinued operations	-	(1,687)
Cash flows relating to financing activities	<b>(2,494)</b>	<b>(4,325)</b>

This year and last year's repayment of long-term debt includes the scheduled repayment of governmental authorities' loans, finance leases for machinery and equipment and a promissory note.

During the first quarter ended June 30, 2013, the Corporation issued 9,336 common shares under the Corporation's stock purchase and ownership incentive plan ("stock purchase plan"), for a total cash consideration of \$67,000. For the same period last year, the Corporation issued 11,093 common shares under its stock purchase plan, for a total cash consideration of \$85,000.

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

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

As at June 30, 2013, the Corporation had 31,520,782 common shares outstanding (31,511,446 as at March 31, 2013).

During the first quarter ended June 30, 2013, the Corporation issued 9,336 common shares under the Corporation's stock purchase plan at a weighted-average price of \$7.14, for a total cash consideration of \$67,000. For the same period last year, the Corporation issued 11,093 common shares under its stock purchase plan at a weighted-average price of \$7.63, for a total cash consideration of \$85,000.

As at June 30, 2013, 259,101 stock options were issued and outstanding with a weighted-average of 3.6 years to maturity and a weighted-average exercise price of \$3.30. During the quarters ended June 30, 2013 and 2012, no stock options were granted, exercised or cancelled.

For the quarter ended June 30, 2013, the stock option plan expense and the stock purchase plan expense amounted to \$36,000 and \$31,000 respectively (\$115,000 and \$38,000 in 2012) - see Note 13 to the interim condensed consolidated financial statements.

As at June 30, 2013, 1,750,381 common shares had not been issued yet under the Stock Option Plan and 264,885 common shares had not been issued yet under the Stock Purchase Plan.

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

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

As at June 30, 2013, 39,000 SARs were still outstanding at a weighted-average granted price of \$2.78, which expire on various dates from fiscal 2014 to 2016. During the quarters ended June 30, 2013 and 2012, no SARs were exercised or cancelled.

As at June 30, 2013, 75,302 DSUs were outstanding. During the quarters ended June 30, 2013 and 2012, no DSUs were granted, exercised or cancelled.

For the first quarter ended June, 2013, SAR expense amounted to \$21,000 (reversal of expense of \$110,000 in 2012) while DSU expense amounted to \$58,000 (reversal of expense of \$14,000 in 2012) - see Note 13 to the interim condensed consolidated financial statements.

## Consolidated Balance Sheets

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

<b>Item</b>	<b>Change (\$ million)</b>	<b>Explanation</b>
Cash and cash equivalents	(4.6)	See consolidated statements of cash flows.
Accounts receivable	(6.6)	Decrease resulting from lower sales in the first quarter this year, compared to last year’s fourth quarter sales. This decrease was partially offset by the impact of a higher US/CAD exchange rate used to convert U.S.-denominated accounts receivable, when compared to March 31, 2013 (impact of \$1.1 million).
Inventories	1.5	The increase reflects the increased volume in the commercial sector and the higher US/CAD exchange rate used to convert the inventories of the U.S. subsidiaries, when compared to March 31, 2013 (impact of \$0.6 million).
Derivative financial instruments (current and long-term assets)	(1.7)	Reflects the variation in the Corporation’s balance sheets of derivative financial instruments measured at fair value. The decrease is mainly the result of a lower differential between the weighted-average US/CAD rates of forward foreign exchange contracts on hand and the closing rate of conversion used, as of both balance sheet dates.

Item	Change (\$ million)	Explanation
Property, plant and equipment, net	(0.4)	<p>Due to:</p> <ul style="list-style-type: none"> <li>• Purchases of property, plant and equipment of \$2.3 million;</li> <li>• A higher US/CAD exchange rate used to convert the property, plant and equipment, net of U.S. subsidiaries, when compared to March 31, 2013 (impact of \$0.3 million).</li> </ul> <p>Net of:</p> <ul style="list-style-type: none"> <li>• Amortization expense (\$3.0 million).</li> </ul>
Finite-life intangible assets, net	2.9	<p>Due to:</p> <ul style="list-style-type: none"> <li>• An increase in capitalized development costs for long-term contracts (\$3.1 million);</li> </ul> <p>Net of:</p> <ul style="list-style-type: none"> <li>• Amortization expense of software (\$0.2 million).</li> </ul>
Accounts payable and accrued liabilities	(4.4)	Decrease resulting mainly from lower sales in the first quarter this year, compared to last year's fourth quarter sales. This decrease was partially offset by the impact of a higher US/CAD exchange rate used to convert U.S.-denominated accounts payable and accrued liabilities, when compared to March 31, 2013 (impact of \$0.6 million).
Accounts payable – other	(1.0)	Decrease mainly reflecting the lower unpaid portion of property, plant and equipment additions.
Progress billings (current and long-term)	(3.4)	The reduction in progress billings mainly reflects a higher commercial funded backlog business mix, and a reduced backlog on certain military programs.
Income tax payable	(2.4)	Decrease mainly reflecting the final income tax payments made this quarter related to the balance due from the last fiscal year.
Derivative financial instruments (short-term and long-term liabilities)	2.6	Reflects the variation in the Corporation's balance sheets of derivative financial instruments measured at fair value. The increase is mainly the result of a higher differential between the closing rate of conversion used and the weighted-average US/CAD rates of forward foreign exchange contracts on hand, as of both balance sheet dates.

Item	Change (\$ million)	Explanation
Long-term debt (including current portion)	(1.2)	<p>Due to:</p> <ul style="list-style-type: none"> <li>• Scheduled capital repayment of long-term debt, mainly governmental authorities loans (\$2.6 million).</li> </ul> <p>Net of:</p> <ul style="list-style-type: none"> <li>• Interest accretion on governmental authorities loans (\$0.5 million);</li> <li>• Amortization of deferred financing costs related to the Credit Facility (\$0.1 million);</li> <li>• A higher US/CAD exchange rate used to convert the long-term debt denominated in US dollars, when compared to March 31, 2013 (\$0.8 million).</li> </ul>
Retained earnings	2.7	The increase reflects the Corporation's net income for the quarter ended June 30, 2013, partially offset by the defined benefit actuarial losses of the Corporation's defined benefit pension plans for the quarter ended June 30, 2013.

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

	June 30, 2013	March 31, 2013
Working capital ratio	<b>3.93:1</b>	3.59:1
Cash and cash equivalents	<b>\$96.7 million</b>	\$101.3 million
Long-term debt-to-equity ratio	<b>0.26:1</b>	0.27:1
Net debt-to-equity ratio <sup>(1)</sup>	<b>(0.15:1)</b>	(0.17:1)

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

### Government assistance

During the first quarter ended June 30, 2013, the Corporation recorded as government assistance an amount of \$0.5 million (\$0.6 million during the same period last year) as a reduction of cost of sales, and an amount of \$0.3 million (\$0.4 million during the same period last year) as a reduction of the related capital expenditures or capitalized development costs presented under Finite-life intangible assets.

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

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

As at June 30, 2013, the Corporation had operating lease obligations amounting to \$1.1 million for buildings and facilities. These amounts are repayable over the next five fiscal years. The Corporation also had machinery and equipment purchase commitments totalling \$3.4 million (see Note 16 to the interim condensed consolidated financial statements).

As at June 30, 2013, the Corporation had FFEC with Canadian chartered banks to sell US\$120.0 million at a weighted-average exchange rate (Canadian dollar over US dollar) of 1.0326. These contracts relate mainly to its export sales, and mature at various dates between July 2013 and March 2017, but mainly this and next fiscal years (see Note 10 to the interim condensed consolidated financial statements). This compares to US\$123.5 million and US\$147.7 million in FFEC held at March 31, 2013 and June 30, 2012 respectively, at weighted-average exchange rates of 1.0325 and 1.0561 respectively. The lower FFEC, compared to last year's period, reflects the changes in the funded backlog.

As at June 30, 2013 and March 31, 2013, the Corporation had also entered into FFEC to sell US\$3.3 million at a weighted-average rate of 1.2262 (Canadian dollar over US dollar) and US\$4.7 million at a weighted-average rate of 1.2262 (Canadian dollar over US dollar), respectively. These contracts cover foreign exchange risk related to certain embedded derivative financial instruments and they all mature this fiscal year.

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

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

### **Financial and Economic Situation**

Improvements in the global economy continue to have a positive effect on most of the Corporation's markets related to commercial aerospace. In the large commercial aircraft market, Boeing and Airbus are proceeding with production rate increases for certain leading programs and backlogs remain strong, representing 7 to 8 years of production at current rates. Business jet shipments rose 4.0% in the first three months of calendar 2013 and key indicators point to a more significant recovery, such as increased aircraft utilization and a reduction in the number of used aircraft for sale, as a percentage of the fleet.

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

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

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

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

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

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

## **CHANGES IN ACCOUNTING POLICIES**

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

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

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

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

The IFRS 13, *Fair Value Measurements* was adopted retrospectively effective April 1<sup>st</sup>, 2013, and is a new and comprehensive standard that sets out a framework for measuring at fair value and that provides guidance on required disclosures about fair value measurements. This change had no impact on the interim condensed consolidated financial statements.

### **IAS 19 Employee Benefits**

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

The impact of the adoption of the amended IAS 19, *Employee Benefits* on the consolidated statement of income and consolidated statement of comprehensive income for the quarter ended June 30, 2012 is as follows:

**(\$'000)**

● Decrease of cost of sales	(18)
● Increase of financial expenses	126
● Decrease of income tax expense	(29)
● Decrease of net income from continuing operations and net income	(79)
● Decrease of actuarial losses, net of income taxes	79
● Increase of other comprehensive income from continuing operations and other comprehensive income	79

### **INTERNAL CONTROLS AND PROCEDURES**

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

No changes were made to the Corporation's internal controls over financial reporting during the first quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **RISKS AND UNCERTAINTIES**

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

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

## SELECTED QUARTERLY FINANCIAL INFORMATION

(\$'000 Except per share data)	Fiscal Year 2014	Fiscal Year 2013				Fiscal Year 2012		
	June 30, 2013	March 31, 2013	Dec. 31, 2012	Sept. 30, 2012	June 30, 2012	March 31, 2012	Dec. 31, 2011	Sept. 30, 2011
Average exchange rate used to translate revenues (sales) and expenses <sup>(1)</sup> (\$Canadian / 1 equivalent \$US)	<b>1.0233</b>	1.0089	0.9913	0.9948	1.0102	1.0012	1.0231	0.9802
Sales from continuing operations	<b>62,972</b>	73,816	61,742	57,684	63,780	74,777	61,988	55,464
EBITDA from continuing operations <sup>(2)</sup>	<b>7,747</b>	10,159	7,672	6,989	8,271	11,473	10,302	7,360
Net income from continuing operations <sup>(2)</sup>	<b>2,814</b>	4,695	3,216	2,645	2,946	5,558	4,463	2,436
Net income from discontinued operations	-	3,679	1,289	110,000	3,258	3,360	2,403	2,331
Net income <sup>(2)</sup>	<b>2,814</b>	8,374	4,505	112,645	6,204	8,918	6,866	4,767
Earnings per share from continuing operations (\$) – Basic <sup>(2)</sup>	<b>0.09</b>	0.15	0.10	0.09	0.10	0.18	0.15	0.08
Earnings per share from continuing operations (\$) – Diluted <sup>(2)</sup>	<b>0.09</b>	0.15	0.10	0.09	0.10	0.18	0.15	0.08
Earnings per share (\$) – basic <sup>(2)</sup>	<b>0.09</b>	0.27	0.14	3.68	0.20	0.29	0.23	0.16
Earnings per share (\$) – diluted <sup>(2)</sup>	<b>0.09</b>	0.26	0.14	3.64	0.20	0.29	0.22	0.16
Weighted-average number of diluted shares outstanding (in millions)	<b>31.7</b>	31.7	31.3	31.0	30.8	30.8	30.7	31.0

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

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

## OUTLOOK

Conditions remain mostly favourable in the commercial aerospace market. The IATA's most recent forecast calls for 5.3% growth in the passenger market for calendar 2013, while air cargo volume is expected to rise 1.5% in calendar 2013. As at the end of May 2013, the passenger market has grown by 4.3%, but the cargo market contracted slightly by 0.2%.<sup>1</sup>

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

<sup>1</sup> Source: IATA Industry Financial Forecast June 2013, press releases July 2, 2013; July 3, 2013.

<sup>2</sup> Sources: Airbus press release April 4, 2013. Boeing press releases May 9, 2013; April 19, 2013; March 18, 2013; November 12, 2012; October 23, 2012.

In the business jet market, deliveries rose 4.0% in the first quarter of calendar 2013 and key indicators point to a more significant recovery, such as increased aircraft utilization and a reduction in the number of used aircraft for sale, as a percentage of the fleet. More importantly, industry sources are calling for sustained growth over up to possibly five years, a period spanning the planned entry into service of several business jet models for which Héroux-Devtek has designed the landing gear.<sup>3</sup>

Conditions in the military aerospace market are expected to remain difficult, as governments are addressing their deficits. In the U.S., proposed funding for the fiscal 2014 base defense budget is down marginally from enacted funding for fiscal 2013<sup>4</sup>, including a proposed funding reduction of 1.4% for equipment, systems, research, technology development and weapons. As proposed funding for fiscal 2014 remains above budget limits set under sequestration, actual funding could be materially less if sequestration is not reversed. Given uncertainty surrounding the duration of sequestration, the Corporation may be affected by U.S. defense cutbacks beyond the current fiscal year, despite having a diversified military portfolio, balanced between new component manufacturing and aftermarket products and services, that should lessen this impact.

The Corporation's balance sheet remains healthy with cash and cash equivalents of \$96.7 million as at June 30, 2013. This amount, combined with funds available under its Credit Facility, will allow Héroux-Devtek to fund expected capital expenditures of approximately \$16 million in fiscal 2014 as well as to consider other strategic acquisitions that would complement its product portfolio and its technologies.

As at June 30, 2013, Héroux-Devtek's funded (firm orders) backlog stood at \$368 million, versus \$361 million three months earlier. Despite this solid backlog and strong customer relationships, the Corporation will continue to enhance productivity and streamline its cost base to remain competitive in light of the increasingly global character of the aerospace industry.

Based on its backlog and current market trends, and assuming the Canadian dollar remains at parity versus the US currency and considering FFEC, the Corporation expects that internal sales growth for the fiscal year ending March 31, 2014 will be marginal. Driven by sustained strength in the large commercial aircraft segment and the recovery of the business jet market, commercial sales could grow by more than 10%, while military sales are expected to further decline as a result of U.S. budgetary restrictions. These restrictions could also affect the timing of military product and service sales. Over the long-term, Héroux-Devtek remains committed to its stated goal of growing, internally and through strategic alliances, at 10% per year, on average, assuming a stable currency environment.

### **Additional Information and Continuous Disclosure**

This MD&A was approved by the Audit Committee and by the Board of Directors on July 31, 2013. Updated information on the Corporation can be found on the SEDAR website, at [www.sedar.com](http://www.sedar.com).

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

<sup>4</sup> Source: U.S. Department of Defense report, April 10, 2013