

August 5, 2014

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS FOR THE 13-WEEKS AND 26-WEEKS ENDED JUNE 29, 2014**

Information in this Management's Discussion and Analysis ("MD&A") relating to the financial condition and results of operations of New Flyer Industries Inc. ("NFI") is supplemental to, and should be read in conjunction with, NFI's interim condensed consolidated financial statements (including notes) (the "Financial Statements") for the 13-week period ("2014 Q2") and the 26-week period ("2014 YTD") ended June 29, 2014. This MD&A contains forward-looking statements, which are subject to a variety of factors that could cause actual results to differ materially from those contemplated by the forward-looking statements. See "Forward-looking Statements". Some of the factors that could cause results or events to differ from current expectations include, but are not limited to, the factors described in the public filings of NFI available on SEDAR at [www.sedar.com](http://www.sedar.com). The Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and, except where otherwise indicated, are presented in U.S. dollars, representing the functional currency of NFI. Unless otherwise indicated, the financial information contained in this MD&A has been prepared in accordance with IFRS and references to "\$" or "dollars" mean U.S. dollars.

**MEANING OF CERTAIN REFERENCES**

References in this MD&A to "New Flyer" or the "Company" are to NFI and its consolidated subsidiaries. References in this MD&A to "management" are to management of NFI and the Company.

The common shares of NFI ("Shares") are traded on the Toronto Stock Exchange ("TSX") under the symbol "NFI" and NFI's 6.25% convertible unsecured subordinated debentures ("Debentures") are traded on the TSX under the symbol "NFI.DB.U". As at June 29, 2014, 55,473,104 Shares and approximately \$65.0 million aggregate principal amount of Debentures were outstanding. The Debentures are convertible at the holder's option into Shares at a conversion price of \$10.00 per Share. Additional information about NFI and the Company, including NFI's annual information form is available on SEDAR at [www.sedar.com](http://www.sedar.com).

All of the data presented in this MD&A with respect to market share, the number of heavy-duty transit buses in service and the number of heavy-duty transit buses delivered is measured in, or based on, "equivalent units". One equivalent unit (or "EU") represents one 30-foot, 35-foot or 40-foot heavy-duty transit bus. One articulated bus represents two equivalent units. An articulated bus is an extra long bus (55-feet to 60-feet in length), composed of two passenger compartments connected by a joint mechanism. The joint mechanism allows the vehicle to bend when the bus turns a corner, yet have a continuous interior.

**Forward-looking Statements**

Certain statements in this MD&A are "forward-looking statements", which reflect the expectations of management regarding NFI's and the Company's future growth, results of operations, performance and business prospects and opportunities. The words "believes", "anticipates", "plans", "expects", "intends", "projects", "forecasts", "estimates" and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this MD&A. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements. Such differences may be caused by factors which include, but are not limited to availability of funding to the Company's customers to purchase buses and to exercise options and to purchase parts or services at current levels or at all, aggressive competition and reduced pricing in the industry, material losses and costs may be incurred as a result of product warranty issues and product liability claims, changes in Canadian or United States tax legislation, the absence of fixed term customer contracts and the termination of contracts by customers for convenience, the current U.S. federal "Buy-America" legislation, certain states' U.S. content bidding preferences and certain Canadian content purchasing policies may change and/or become more onerous, production delays may result in liquidated damages under the Company's contracts with its customers, the Company's ability to execute its planned production targets as required for current business and operational needs, currency fluctuations could adversely affect the Company's financial results or competitive position in the industry, the Company may not be able to maintain performance bonds or letters of credit required by its existing contracts or obtain performance bonds and letters of credit required for new contracts, third party debt service obligations may have important consequences to the Company, the covenants contained in the Company's senior credit facility ("Credit Facility") and the indenture governing its Debentures could impact the ability of the Company to fund dividends and take certain other actions, interest rates could change substantially and materially impact the Company's profitability, the dependence on limited sources of supply, the timely supply of materials from suppliers, the

possibility of fluctuations in the market prices of the pension plan investments and discount rates used in the actuarial calculations will impact pension expense and funding requirements, the Company's profitability and performance can be adversely affected by increases in raw material and component costs, the availability of labour could have an impact on production levels, new products must be tested and proven in operating conditions and there may be limited demand for such new products from customers, the ability to successfully complete the product rationalization of the NABI bus platform, on budget and on schedule, the ability of the Company to successfully execute strategic plans and maintain profitability, risks related to acquisitions, joint ventures, and other strategic relationships with third parties and the ability to successfully integrate acquired businesses and assets into the Company's existing business and to generate accretive effects to income and cash flow as a result of integrating these acquired businesses and assets. NFI cautions that this list of factors is not exhaustive. These factors and other risks and uncertainties are discussed in NFI's press releases and materials filed with the Canadian securities regulatory authorities and are available on SEDAR at [www.sedar.com](http://www.sedar.com).

Although the forward-looking statements contained in this MD&A are based upon what management believes to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this MD&A and NFI and the Company assume no obligation to update or revise them to reflect new events or circumstances, except as required by applicable securities laws.

#### **DEFINITIONS OF EARNINGS FROM OPERATIONS, EBITDA, ADJUSTED EBITDA AND FREE CASH FLOW**

References to "Earnings from Operations" are to earnings before interest, income taxes, impairment loss on equipment and intangible assets and unrealized foreign exchange losses or gains on non-current monetary items. References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization, and unrealized foreign exchange losses or gains on non-current monetary items. References to "Adjusted EBITDA" are to EBITDA after adjusting for: the effects of certain non-recurring and/or non-operations related items that have impacted the business and are not expected to recur, including non-recurring transitional costs relating to business acquisitions, product rationalization costs, impairment loss on equipment and intangible assets, realized investment tax credits ("ITCs"), stock-based compensation and costs associated with assessing strategic and corporate initiatives. "Free Cash Flow" means net cash generated by operating activities adjusted for changes in non-cash working capital items, interest paid, interest expense, income taxes paid, current income tax expense, effect of foreign currency rate on cash, defined benefit funding, non-recurring transitional costs relating to business acquisitions, costs associated with assessing strategic and corporate initiatives, product rationalization costs, defined benefit expense, cash capital expenditures and principal payments on capital leases.

Management believes Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow are useful measures in evaluating the performance of the Company. However, Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow are not recognized earnings measures under IFRS and do not have standardized meanings prescribed by IFRS. Readers of this MD&A are cautioned that Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow should not be construed as an alternative to net earnings or loss determined in accordance with IFRS as an indicator of NFI's and/or the Company's performance or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. A reconciliation of net earnings and cash flow to EBITDA and Adjusted EBITDA, based on the Financial Statements, has been provided under the headings "Reconciliation of Net Earnings to EBITDA and Adjusted EBITDA" and "Reconciliation of Cash Flow to EBITDA and Adjusted EBITDA", respectively. A reconciliation of Free Cash Flow to cash flows from operations is provided under the heading "Summary of Free Cash Flow".

NFI's method of calculating Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow may differ materially from the methods used by other issuers and, accordingly, may not be comparable to similarly titled measures used by other issuers. Dividends paid from Free Cash Flow are not assured, and the actual amount of dividends received by holders of Shares will depend on, among other things, the Company's financial performance, debt covenants and obligations, working capital requirements and future capital requirements, all of which are susceptible to a number of risks, as described in NFI's public filings available on SEDAR at [www.sedar.com](http://www.sedar.com).

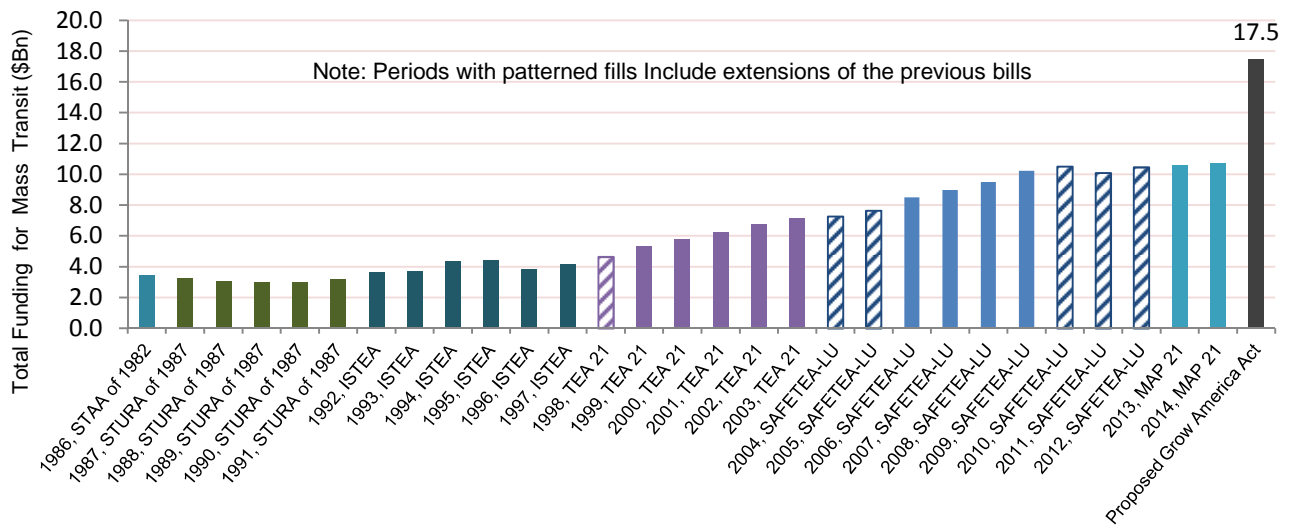
#### **Business Overview**

New Flyer is the leading manufacturer of heavy-duty transit buses in the United States and Canada. The Company is the industry technology leader and offers the broadest product line including drive systems powered by: clean diesel, natural gas and electric trolley as well as energy-efficient diesel-electric hybrid vehicles and now all-electric buses. All buses are supported by an industry-leading comprehensive warranty and support program, and service network. New Flyer and its subsidiary NABI Parts, LLC ("NABI Parts") also operate the industry's most sophisticated aftermarket parts organization, sourcing parts from hundreds of different suppliers and providing support for all types of heavy-duty transit buses. The New Flyer group of companies employ over 3,000 team members with manufacturing, fabrication, parts distribution and service centers in both Canada and the United States.

## Industry Overview

### Funding and the U.S. Economy

The U.S. federal transit program is funded from general revenues of the government and from revenues credited to the Mass Transit Account of the Highway Trust Fund (“HTF”). Each year, new legislation must be passed to appropriate general revenues that will fund transit programs and set an obligation limitation that allows expenditure of funds from the Mass Transit Account for transit programs. The current funding bill, MAP-21, expires on September 30, 2014.



Source: APTA, AltaCorp Capital

On March 4, 2014, President Obama released a \$90.9 billion budget for Department of Transportation for fiscal year 2015 as part of a \$302 billion, four-year surface transportation reauthorization (“The Grow America Act”). The Grow America Act proposes \$72.3 billion for public transportation over four years, including \$17.5 billion in fiscal year 2015, a \$6.8 billion increase over fiscal year 2014. The budget recommendation proposes significant increases in funding for the state-of-good repair and bus and bus facilities accounts, which have historically been a source of funding for bus replacement and bus maintenance activities for US transit agencies. The recommendation also introduces a \$500 million discretionary program aimed at establishing bus rapid transit (“BRT”) service in areas with rapidly growing populations.

On July 10, 2014, both the Senate Finance Committee and the House Ways and Means Committee voted for legislation that provides a revised package of offsets to provide a General Fund transfer and address the pending insolvency of the HTF. The new package makes approximately \$10.8 billion available for the Highway Account (\$8.8 billion) and Mass Transit Account (\$2 billion) of the HTF, effectively providing sufficient funds to support highway and transit expenditures through May 2015.

On July 15, 2014, the U.S. House of Representatives (“House”) approved a bill to temporarily fund and ensure solvency of the HTF through May 2015. On July 31, 2014, the U.S. Senate approved the legislation passed by the House. The HTF extension bill must now be approved by U.S. President Barak Obama.

The Grow America Act includes increases to address the bus and rail state-of-good repair backlog. The proposed bill also highlights changes to Buy America and local hiring rules. The proposal calls for changes to the Buy America requirements that would increase the U.S. content requirements for transit buses from the current 60 percent U.S. content to 70 percent U.S. content in 2016. The U.S. content requirement would then increase to 80 percent in 2017, 90 percent in 2018 and 100 percent in 2019.

New Flyer has been very active with the American Public Transportation Association (“APTA”) and Canadian Urban Transit Association on providing feedback and insights on The Grow America Act and its various elements, including the proposed changes to the Buy America requirements. On July 9, 2014 New Flyer President and CEO Paul Soubry participated in a closed-door roundtable on the US Administrations Transportation and Infrastructure as proposed in The Grow America Act. The event was hosted by U.S. Vice President Joe Biden and Transportation Secretary Anthony Foxx.

Management remains encouraged with general economic health improvement of the U.S. states. Preliminary data from the Rockefeller Institute (Preliminary Report on May 6, 2014) reports state tax collections increasing slightly in the first quarter of 2014 for the 17th consecutive quarter, with a 0.7% increase over the prior year. As well, the U.S. Bureau of Labor Statistics (Employment Situation Summary on July 3, 2014) reports U.S. unemployment declined 0.6% during the quarter, ending with a rate of 6.1% in June.

#### *Recent Ridership Trends*

The latest data from APTA indicates generally stable ridership during the first quarter of 2014. The report indicated a slight decrease of 0.67% in all modes of U.S. transit ridership during the first quarter of 2014 compared with the previous year; including a decrease in bus ridership of 2.86%. The same report indicates Canadian ridership slightly increased by 0.66% in all modes of transit ridership during the first quarter of 2014 as compared to the previous year; however, specific data on bus ridership is not available.

#### *Demand for Heavy-Duty Transit Buses*

Bus manufacturers have some forward order visibility due to the fleet planning, budgeting and funding application processes customers undertake in order to purchase new vehicles. The Company tracks new and potential orders in a “pipeline” or “bid universe” as a key indicator in support of management’s forecast for overall market demand and bid activity for the heavy-duty transit bus industry in Canada and the United States. The pipeline of “Active EUs” consists of: bids received with proposal in process and bids submitted and awaiting award. The bid universe consists of the pipeline of Active EUs and solicitations that management expects to be released by U.S. and Canadian transit agencies within a five-year horizon. Effective the first quarter of 2014, the bid universe now includes MiDi® opportunities.

| Period         | Bids in Process (EUs) | Bids Submitted (EUs) | Active EUs   | Forecasted Future Industry Procurement over 5 Years (EUs) <sup>(1)</sup> | Total Bid Universe (EUs) |
|----------------|-----------------------|----------------------|--------------|--|--------------------------|
| 2013 Q2        | 3,620                 | 4,869                | 8,489        | 9,608  | 18,097                   |
| 2013 Q3        | 2,121                 | 5,996                | 8,117        | 11,824   | 19,941                   |
| 2013 Q4        | 909                   | 5,329                | 6,238        | 12,354   | 18,592                   |
| 2014 Q1        | 3,626                 | 2,045                | 5,671        | 15,567   | 21,328                   |
| <b>2014 Q2</b> | <b>2,772</b>          | <b>1,926</b>         | <b>4,698</b> | <b>15,030</b>  | <b>19,728</b>            |

(1) Management’s estimate of expected future industry procurement over the next five years is based on discussions directly with certain individual U.S. and Canadian transit authorities.

A lag in procurement activity was experienced in the first half of 2014, followed by an increase in new RFPs issued, however, the average number of EUs under each RFP decreased compared to 2013. Management anticipates that the amount of bus procurement activity by public transit agencies throughout the United States and Canada should recover throughout 2014 and 2015 based on expected customer fleet replacement plans.

#### *Aftermarket Parts*

The aftermarket parts market consists of approximately 90% government municipalities and transit authorities and 10% private operators (such as rental car agencies). The complexity of the technologies integrated into transit buses, coupled with transit authorities’ constrained operating budgets and high bus utilization levels continue to drive demand for aftermarket parts and support. The Company’s leading share of in-service heavy-duty transit buses provides recurring demand and a significant opportunity to grow its aftermarket business. The Company provides parts and support for buses manufactured by New Flyer, NABI, Orion and other manufacturers. To assess the aftermarket parts market outlook, the Company regularly monitors the change in aftermarket parts operating budgets of some of the largest transit authorities. Management’s latest review indicates that the aftermarket parts industry is expected to continue to improve.

## 2014 Second Quarter in Review

### Bus order activity during 2014 Q2

New orders (firm and options) for 2014 Q2 totaled 476 EUs. The new firm and option orders awarded to New Flyer for the last twelve months (“LTM”) ending June 29, 2014 were 3,797 EUs compared to 4,019 EUs during the 52-week period ended June 30, 2013 (“2013 Q2 LTM”). Also, New Flyer was successful at converting 121 EUs of options during 2014 Q2, which contributed to the 966 EUs of options converted in 2014 Q2 LTM as compared to 676 EUs during 2013 Q2 LTM. In 2014 Q2, options containing 205 EUs expired.

|                | New Orders<br>in Quarter<br>(Firm and<br>Option EUs) | LTM New Orders<br>(Firm and<br>Option EUs) | Option EU<br>Conversions in<br>Quarter | LTM Option EU<br>Conversions |
|----------------|--|--|--|------------------------------|
| 2013 Q1        | 2,004  | 3,596                                      | 224                                    | 1,046                        |
| 2013 Q2        | 513  | 4,019                                      | 38                                     | 676                          |
| 2013 Q3        | 2,431  | 6,003                                      | 116                                    | 568                          |
| 2013 Q4        | 331  | 5,279                                      | 223                                    | 601                          |
| 2014 Q1        | 559  | 3,834                                      | 506                                    | 883                          |
| <b>2014 Q2</b> | <b>476</b>   | <b>3,797</b>                               | <b>121</b>                             | <b>966</b>                   |

At the end of 2014 Q2, New Flyer's total backlog was 7,372 EUs (for a total value of approximately \$3.54 billion) compared to 7,678 EUs (for a total value of approximately \$3.66 billion) at the end of the 13-week period ended December 30, 2013 (“2013 Q4”). The firm portion of the total backlog at the end of 2014 Q2 is made up of 2,228 EUs which has decreased slightly compared with 2,276 EUs at the end of 2013 Q4. The Company's backlog includes MiDi<sup>®</sup>.

New Flyer's backlog includes orders and options for clean propulsion vehicles (consisting of electric-hybrid, electric-trolley, compressed natural gas, liquid natural gas and all-electric) representing approximately 65% of the total backlog.

At the end of 2014 Q2, new firm and option orders of 239 EUs were pending from customers where approval of the award had been made by the customer's board, council, or commission, as applicable, but purchase documentation had not yet been received by the Company. These firm and option orders are not yet included in the backlog.

Deliveries in 2014 Q2 were 582 EUs, which increased 19.0% from 489 EUs delivered in the 13-week period ended June 30, 2013 (“2013 Q2”), primarily due to the addition of NABI Bus, LLC (“NABI Bus”) deliveries. However, the number of EUs delivered in 2014 Q2 was negatively impacted by 60 EUs that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries in respect of these contracts by year-end. The ending work in process (“WIP”) levels at June 29, 2014 were 366 EUs. The Company line entered 642 EUs (which includes MiDi<sup>®</sup>) in 2014 Q2, as planned.

In May 2014, New Flyer successfully delivered its first MiDi<sup>®</sup> to a Canadian private bus operator. The MiDi<sup>®</sup> is a medium sized bus, ideal for use in shuttle operations at universities or airports and fixed route transit service in smaller towns and cities. During the period, the MiDi<sup>®</sup> also successfully completed the New Model Bus Testing program in Altoona, PA (“Altoona Testing”), and is now eligible for bus procurements using FTA funding grants.

In June 2014, the Company delivered its first two production battery-electric buses to a public transit agency in the United States, as part of a technology demonstration program. The XE40<sup>®</sup> is New Flyer's battery-electric, zero emission heavy duty transit bus based on the proven Xcelsior<sup>®</sup> platform. Four additional battery-electric buses have been manufactured and are in the process of completing a comprehensive test protocol, including Altoona Testing. They are expected to enter service with Winnipeg Transit in a few months.

New Flyer's 2014 Q2 LTM Book-to-Bill ratio (defined as new firm and option orders divided by deliveries) was 162%. This is the sixth consecutive quarter with a LTM Book-to-Bill ratio greater than 100%. A ratio above 100% implies that more orders were received than filled, indicating increasing demand for New Flyer products.

### Aftermarket order activity during 2014 Q2

Gross orders received by New Flyer's aftermarket parts business during 2014 Q2 increased 42% compared to 2013 Q2. Parts shipments in 2014 Q2 also increased 55% over 2013 Q2.

Quarter-over-quarter 2014 Q2 actual part shipments were up 11% over 2014 Q1, while gross parts orders fell slightly by 1% over 2014 Q1.

### **2014 Second Quarter Financial Results**

The Company generated consolidated revenue of \$346.5 million for 2014 Q2, an increase of 30.0% compared to consolidated revenue for 2013 Q2 of \$266.6 million, and consolidated revenue for 2014 YTD of \$670.3 million, an increase of 31.0% from consolidated revenue for the 26-week period ended June 30, 2013 ("2013 YTD") of \$511.7 million. The revenue growth primarily resulted from business acquisitions in Fiscal 2013 and the Chicago Transit Authority ("CTA") midlife overhaul program.

Revenue from bus manufacturing operations for 2014 Q2 was \$265.8 million, an increase of 23.5% from \$215.2 million in 2013 Q2. The increase in 2014 Q2 revenue primarily resulted from a 19.0% increase in total bus deliveries of 582 EUs in 2014 Q2 compared to 2013 Q2 deliveries of 489 EUs and a 3.8% increase in average selling price per EU in 2014 Q2 of \$456.8 thousand compared to \$440.1 thousand in 2013 Q2. Similarly, bus revenue for 2014 YTD of \$516.7 million increased 22.1% from \$423.0 million for 2013 YTD. Bus deliveries of 1,136 EUs in 2014 YTD increased 16.0% compared to 979 EUs in 2013 YTD and the average selling price per EU in 2014 YTD of \$454.9 thousand increased 5.3% from \$432.1 thousand in 2013 YTD. The increase in average selling price is the result of changes in the product sales mix, which included more sales of hybrid buses and fewer articulated buses. The average selling price can be volatile when comparing two fiscal quarters as a result of sales mix. The increased deliveries primarily were as a result of including NABI Bus deliveries effective June 21, 2013. However, WIP at the end of 2014 Q2, which now includes 15 MiDi<sup>®</sup> buses, increased by 60 EUs over the WIP at the end of 2014 Q1. These 60 EUs that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries on these contracts by year end.

Revenue from aftermarket operations in 2014 Q2 was \$80.7 million, an increase of 57.1% compared to \$51.3 million in 2013 Q2. Revenue from aftermarket operations for 2014 YTD was \$153.6 million, an increase of 73.2% compared to \$88.7 million in 2013 YTD. The increase in aftermarket operations revenue is primarily a result of increased volumes as a result of incremental revenue from the CTA midlife overhaul program, the Orion parts business and the NABI Parts business.

Consolidated Adjusted EBITDA for 2014 Q2 totaled \$27.0 million (7.8% of revenue) compared to \$18.1 million (6.8% of revenue) in 2013 Q2, which represents an increase of 49.3%. In comparing the respective periods, this increase in consolidated Adjusted EBITDA is primarily due to the incremental aftermarket operations volume and increased bus deliveries. 2014 YTD consolidated Adjusted EBITDA of \$46.6 million (7.0% of revenue) increased by 39.5% compared to 2013 YTD consolidated Adjusted EBITDA of \$33.4 million (6.5% of revenue).

2014 Q2 bus manufacturing operations Adjusted EBITDA of \$13.9 million (5.2% of revenue) increased 31.6% compared with 2013 Q2 bus manufacturing operations Adjusted EBITDA of \$10.6 million (4.9% of revenue). The increase is primarily a result of increased bus deliveries and a \$1.9 million increase in realized ITCs. Bus manufacturing operations Adjusted EBITDA of \$21.6 million (4.2% of revenue) for 2014 YTD increased 5.8% compared to \$20.5 million (4.8% of revenue) for 2013 YTD. Management has continued its efforts to recover margins during 2014 YTD through cost reductions, improved labour efficiency and beneficial price change orders with customers. Profit margins have decreased when comparing the two periods. Profit margins can vary significantly between orders due to factors such as pricing, order size and product type and components specified by the customer. Adjusted EBITDA from bus manufacturing operations per EU can be volatile on a quarterly basis and therefore, management believes that a longer term view should be taken when comparing bus manufacturing operations margins. However, management had anticipated and previously provided guidance that on average, margins on orders planned for production throughout Fiscal 2014 will be lower than the average margins achieved during Fiscal 2013.

2014 Q2 aftermarket operations Adjusted EBITDA of \$13.1 million (16.2% of revenue) increased 74.1% compared to \$7.5 million (14.6% of revenue) in 2013 Q2, primarily due to the additional Adjusted EBITDA generated by the CTA midlife overhaul program and the acquisition of NABI Parts and the Orion parts businesses. The aftermarket operations Adjusted EBITDA for 2014 Q2 was normalized for \$0.1 million of non-recurring costs relating to business acquisition as compared to \$0.6 million during 2013 Q2.

Aftermarket operations Adjusted EBITDA for 2014 YTD of \$25.0 million (16.3% of revenue) represents an increase of 92.5% over 2013 YTD aftermarket operations Adjusted EBITDA of \$13.0 million (14.6% of revenue). Profit margins have improved during 2014 YTD primarily as a result of improved market fundamentals and the benefits to the product mix that has resulted from a far broader portfolio of services and parts offerings to customers.

The Company reported net earnings of \$3.6 million in 2014 Q2, an increase compared to net earnings of \$1.7 million in 2013 Q2, primarily as a result of improved Earnings from Operations offset by increased income taxes and a \$3.9 million impairment charge related to product rationalization of the NABI Bus platform. Management carried out a review of the recoverable amount of related assets. The review led to the recognition of an impairment loss of \$3,800 relating to the NABI Bus trade name. Management also identified \$119 of NABI Bus related equipment that no longer meets the definition of an asset and has been fully written-off. The total impairment loss of \$3,919 has been included in net earnings and total comprehensive income.

The Company's net earnings per share in 2014 Q2 were \$0.06, a 100.0% increase from net earnings per share of \$0.03 generated during 2013 Q2. Similarly, 2014 YTD net earnings of \$9.0 million increased compared to 2013 YTD net earnings of \$5.2 million. Net earnings per share in 2014 YTD were \$0.16 compared to \$0.11 generated during 2013 YTD.

The Company generated Free Cash Flow of C\$15.9 million during 2014 Q2 as compared to C\$9.2 million in 2013 Q2 primarily as a result of improved Earnings from Operations. The Company declared dividends in 2014 Q2 of C\$8.1 million as compared to C\$7.5 million in 2013 Q2. The amount of dividends declared increased in 2014 Q2 primarily as a result of issuing 6.2 million Shares on June 21, 2013 to Marcopolo S.A. ("Marcopolo").

The Company generated Free Cash Flow of C\$26.5 million during 2014 YTD as compared to C\$16.2 million in 2013 YTD. The Company declared dividends in 2014 YTD of C\$16.2 million as compared to C\$14.5 million in 2013 YTD. The amount of dividends declared increased in 2014 YTD primarily as a result of issuing 11.1 million Shares in Fiscal 2013 to Marcopolo. Management believes that sufficient Free Cash Flow will be generated to maintain the current dividend rate of C\$0.585 per Share. The Board set this current annual dividend rate effective August 2012. The Company has paid dividends to shareholders for 105 consecutive months since the Company's initial public offering in August 2005.

During 2014 Q2, the Company decreased its cash by \$9.9 million, partially due to increased investment in non-cash working capital items, such as increased inventories and decreased accounts payables partially offset by decreased accounts receivables. Inventory increased by 60 EUs over the WIP at the end of 2014 Q1. The 60 EUs that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries on these contracts by year end.

The June 29, 2014 liquidity position of \$67.4 million is comprised of available cash of \$4.3 million and \$63.1 million available under the Company's revolving credit facility ("Revolver") as compared to a liquidity position of \$69.2 million at December 29, 2013. As at June 29, 2014, there were \$30.0 million of direct borrowings and \$21.9 million of outstanding letters of credit related to the \$115.0 million Revolver. Management believes that these funds, together with the cash generated from the Company's operating activities will provide the Company with sufficient liquidity and capital resources to meet its current financial obligations as they come due, as well as provide funds for its financing requirements, capital expenditures, dividend payments and other operational needs for the foreseeable future.

## **Business Outlook**

On June 24, 2014, the Company announced its decision to focus on a single heavy-duty transit and BRT bus platform that features its Xcelsior®. Xcelsior® comes with a variety of propulsion options including clean diesel, natural gas, diesel-electric hybrid, electric-trolley, and now, zero emission battery-electric. Similar to the New Flyer's previous bus models, Xcelsior® is customized and configured to meet each customer's unique specifications. The Company plans to further enhance its BRT styling options for the Xcelsior platform by building on NABI's extensive BRT experience and while taking into account customer input.

The Company's decision to rationalize to a common Xcelsior® platform for all heavy-duty and BRT transit buses is expected to allow for improvement in competitiveness in the U.S. and Canadian markets by leveraging its combined bus volume, production, and purchasing for greater efficiencies. Management expects to streamline design, sourcing, standardization, and overhead for better product control (such as eliminating redundancy and future costs in designing products, including refreshing bus and propulsion platforms, testing and engineering). It is also anticipated to enable product enhancements and optimize aftermarket support to better serve customer needs. The plan involves a transition to common information technology infrastructure.

During this transition period, management expects to invest approximately \$20 million in direct operating costs and capital expenditures to complete the transition, utilizing operating cash flow and current credit facilities. Management anticipates these direct operating and capital expenditures will be paid back through captured cost reductions and synergies within approximately two to three years. As at June 29, 2014, the Company had spent \$96 thousand on related costs which has resulted in \$176 thousand of annual salary reductions.

Production of NABI Bus LFW and BRT models are to be phased out, with the Anniston, Alabama facility transitioning to Xcelsior in the second half of 2015.

New Flyer expects to deliver orders as previously committed and to provide support for NABI Bus customers of the LFW and BRT products for as long as those buses are in service. A number of NABI Bus customers have already indicated an interest in transitioning to Xcelsior. The Company believes customers will benefit from the enhancements that result from its focus on a single heavy-duty platform.

Management believes pricing in certain types of bus competitions has begun to normalize. Management continues to pursue cost and overhead savings as a result of its decision to focus on the Xcelsior® bus platform as well as in daily operations through its Operational Excellence initiatives. Management anticipates that based on the current production schedule which includes a higher mix of articulated buses; the Company will temporarily operate at an average combined line entry rate of approximately 51 EUs per week during Fiscal 2014 at the New Flyer and NABI Bus production facilities. The average line entry rate reflects the production of MiDi®. Management has not yet finalized production rates for Fiscal 2015.



## SELECTED QUARTERLY AND ANNUAL FINANCIAL AND OPERATING INFORMATION

The following selected consolidated financial and operating information of the Company has been derived from and should be read in conjunction with the historical financial statements of the Company.

(unaudited, U.S. dollars in thousands, except for deliveries in EUs and per Share figures)

| Fiscal Period | Quarter      | Revenue*            | Earnings from Operations <sup>(1)</sup> | Net earnings     | EBITDA <sup>(1)</sup> | Adjusted EBITDA <sup>(1)</sup> | Earnings per share |
|---------------|--------------|---------------------|---|------------------|-----------------------|--------------------------------|--------------------|
| 2014          | Q2           | \$ 346,484          | \$ 15,682                               | \$ 3,563         | \$ 19,894             | \$ 26,966                      | \$ 0.06            |
|               | Q1           | 323,865             | 10,384                                  | 5,484            | 18,102                | 19,666                         | 0.10               |
|               | <b>Total</b> | <b>\$ 670,349</b>   | <b>\$ 26,066</b>                        | <b>\$ 9,047</b>  | <b>\$ 37,996</b>      | <b>\$ 46,632</b>               | <b>\$ 0.16</b>     |
| 2013          | Q4           | \$ 381,204          | \$ 23,977                               | \$ 13,732        | \$ 31,281             | \$ 36,830                      | \$ 0.25            |
|               | Q3           | 306,509             | 13,842                                  | 7,832            | 21,710                | 24,416                         | 0.14               |
|               | Q2           | 266,576             | 6,794                                   | 1,684            | 13,331                | 18,063                         | 0.03               |
|               | Q1           | 245,135             | 6,496                                   | 3,513            | 12,788                | 15,376                         | 0.08               |
|               | <b>Total</b> | <b>\$ 1,199,424</b> | <b>\$ 51,109</b>                        | <b>\$ 26,761</b> | <b>\$ 79,110</b>      | <b>\$ 94,685</b>               | <b>\$ 0.52</b>     |
| 2012          | Q4           | \$ 208,141          | \$ 7,725                                | \$ 3,929         | \$ 14,061             | \$ 14,451                      | \$ 0.09            |
|               | Q3           | 206,384             | 7,820                                   | 1,523            | 13,889                | 14,072                         | 0.03               |
|               | Q2           | 224,762             | 10,686                                  | 3,398            | 11,055                | 16,366                         | 0.08               |
|               | Q1           | 225,963             | 7,260                                   | 440              | 13,282                | 15,936                         | 0.01               |
|               | <b>Total</b> | <b>\$ 865,250</b>   | <b>\$ 33,491</b>                        | <b>\$ 9,290</b>  | <b>\$ 52,287</b>      | <b>\$ 60,825</b>               | <b>\$ 0.21</b>     |

| Fiscal Period | Quarter      | Inventory, Beginning (equivalent units) <sup>(2)</sup> | NABI inventory acquired (equivalent units) <sup>(2)</sup> | New Line Entry (equivalent units) <sup>(2)</sup> | Deliveries (equivalent units) <sup>(2)</sup> | Inventory, Ending (equivalent units) <sup>(2)</sup> | Inventory comprised of:                           |  |
|---------------|--------------|--|---|--|--|---|---|--|
|               |              |  |   |  |  |   | Work in process (equivalent units) <sup>(2)</sup> | Finished goods (equivalent units) <sup>(2) &amp; (3)</sup> |
| 2014          | Q2           | 306  | —   | 642  | 582  | 366   | 292   | 74   |
|               | Q1           | 273  | —   | 587  | 554  | 306   | 286   | 20   |
|               | <b>Total</b> | <b>273</b>   | <b>—</b>  | <b>1,229</b>                                     | <b>1,136</b>                                 | <b>366</b>  | <b>292</b>  | <b>74</b>  |
| 2013          | Q4           | 320  | —   | 588  | 635  | 273   | 241   | 32   |
|               | Q3           | 305  | —   | 592  | 577  | 320   | 294   | 26   |
|               | Q2           | 203  | 116   | 475  | 489  | 305   | 301   | 4  |
|               | Q1           | 225  | —   | 468  | 490  | 203   | 199   | 4  |
|               | <b>Total</b> | <b>225</b>   | <b>116</b>  | <b>2,123</b>                                     | <b>2,191</b>                                 | <b>273</b>  | <b>241</b>  | <b>32</b>  |
| 2012          | Q4           | 183  | —   | 429  | 387  | 225   | 217   | 8  |
|               | Q3           | 187  | —   | 382  | 386  | 183   | 178   | 5  |
|               | Q2           | 175  | —   | 453  | 441  | 187   | 167   | 20   |
|               | Q1           | 189  | —   | 428  | 442  | 175   | 163   | 12   |
|               | <b>Total</b> | <b>189</b>   | <b>—</b>  | <b>1,692</b>                                     | <b>1,656</b>                                 | <b>225</b>  | <b>217</b>  | <b>8</b>   |

(\*)Revenue has been restated for a correction of an error relating to revenue recognition of extended warranties as follows:

| \$U.S. in thousands | 2012 Q1 | 2012 Q2 | 2012 Q3 | 2012 Q4 | 2013 Q1 | 2013 Q2 | 2013 Q3 | 2013 Q4 |
|---------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Decrease in revenue | 1,681   | 2,218   | 2,037   | 1,729   | 2,243   | 2,093   | 2,447   | 2,753   |

The correction also equally decreased cost of sales and therefore did not have an impact on Earnings from Operations, net earnings, assets, liabilities or ending deficit of the Company. For details, see note 2.5 of the Financial Statements.

## COMPARISON OF SECOND QUARTER AND TRAILING TWELVE MONTHS RESULTS

(Unaudited, U.S. dollars in thousands, except for deliveries in EUs)

|   | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013<br>(*restated) | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013<br>(*restated) | 52-Weeks<br>Ended<br>June 29, 2014 | 52-Weeks<br>Ended<br>June 30, 2013<br>(*restated) |
|---|------------------------------------|---|------------------------------------|---|------------------------------------|---|
| <b>Statement of Earnings Data</b>   |                                    |   |                                    |   |                                    |   |
| <b>Revenue</b>  |                                    |   |                                    |   |                                    |   |
| Canada  | \$ 33,321                          | \$ 29,884   | \$ 67,150                          | \$ 68,254   | \$ 127,841                         | \$ 110,213  |
| U.S.  | 232,510                            | 185,346   | 449,570                            | 354,771   | 950,279                            | 669,309   |
| Bus manufacturing operations  | 265,831                            | 215,230   | 516,720                            | 423,025   | 1,078,120                          | 779,522   |
| Canada  | 17,645                             | 16,704  | 32,867                             | 28,949  | 62,486                             | 46,648  |
| U.S.  | 63,008                             | 34,642  | 120,762                            | 59,737  | 217,456                            | 100,066   |
| Aftermarket operations  | 80,653                             | 51,346  | 153,629                            | 88,686  | 279,942                            | 146,714   |
| Total revenue   | \$ 346,484                         | \$ 266,576  | \$ 670,349                         | \$ 511,711  | \$ 1,358,062                       | \$ 926,236  |
| Earnings from Operations <sup>(1)</sup>   | \$ 15,682                          | \$ 6,794  | \$ 26,066                          | \$ 13,290   | \$ 63,885                          | \$ 28,835   |
| Earnings before interest and<br>income taxes  | 12,763                             | 4,903   | 22,767                             | 11,174  | 60,556                             | 25,583  |
| Net earnings  | 3,563                              | 1,684   | 9,047                              | 5,197   | 30,611                             | 10,649  |
| EBITDA <sup>(1)</sup>   | 19,894                             | 13,331  | 37,996                             | 26,119  | 90,987                             | 54,069  |
| Adjusted EBITDA <sup>(1)</sup>  |                                    |   |                                    |   |                                    |   |
| Bus manufacturing operations<br>including realized foreign<br>exchange losses/gains | 13,889                             | 10,553  | 21,640                             | 20,454  | 64,835                             | 40,220  |
| Aftermarket operations  | 13,077                             | 7,510   | 24,992                             | 12,985  | 43,043                             | 21,742  |
| Total Adjusted EBITDA <sup>(1)</sup>  | \$ 26,966                          | \$ 18,063   | \$ 46,632                          | \$ 33,439   | \$ 107,878                         | \$ 61,962   |
| <b>Other Data</b>   |                                    |   |                                    |   |                                    |   |
| Canada  | 85                                 | 74  | 169                                | 166   | 320                                | 267   |
| U.S.  | 497                                | 415   | 967                                | 813   | 2,028                              | 1,485   |
| Total deliveries (equivalent units) <sup>(2)</sup>                                  | 582                                | 489   | 1,136                              | 979   | 2,348                              | 1,752   |
| Total capital expenditures  | \$ 3,219                           | \$ 2,622  | \$ 6,809                           | \$ 3,635  | \$ 19,681                          | \$ 10,479   |
| New options awarded   | \$ 149,072                         | \$ 115,375  | \$ 218,279                         | \$ 835,185  | \$ 1,148,963                       | \$ 1,145,492                                      |
| New firm orders awarded   | 41,621                             | 108,654   | 222,448                            | 337,654   | 821,688                            | 668,205   |
| Exercised options   | 61,890                             | 17,645  | 338,418                            | 116,795   | 496,024                            | 308,745   |
| Total firm orders   | \$ 103,511                         | \$ 126,299  | \$ 560,866                         | \$ 454,449  | \$ 1,317,712                       | \$ 976,950  |

(\*) Revenue for the 13-weeks, 26-weeks and 52-weeks ended June 30, 2013 has been restated for a correction of an error relating to revenue recognition of extended warranties. The correction also equally decreased cost of sales and therefore did not have an impact on Earnings from Operations, net earnings, assets, liabilities or ending deficit of the Company. For details, see footnote on page 9 of this MD&A and note 2.5 of the Financial Statements.

(Unaudited, U.S. dollars in thousands)

|  | June 29, 2014 |                                 | December 29, 2013 |                                 | December 30, 2012 |                                 |
|--|---------------|---------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| <b>Selected Statement of Financial Position Data</b> |               |                                 |                   |                                 |                   |                                 |
| Total assets   | \$            | 1,093,738                       | \$                | 1,136,402                       | \$                | 897,224                         |
| Long-term financial liabilities                      |               | 333,540                         |                   | 346,233                         |                   | 322,844                         |
| <b>Other Data</b>                                    |               |                                 |                   |                                 |                   |                                 |
|  |               | Equivalent Units <sup>(2)</sup> |                   | Equivalent Units <sup>(2)</sup> |                   | Equivalent Units <sup>(2)</sup> |
| Firm orders - USA                                    | \$            | 1,027,667                       | 1,930             | \$                              | 1,031,743         | 2,088                           |
| Firm orders - Canada                                 |               | 122,742                         | 298               |                                 | 71,220            | 188                             |
| Total firm orders                                    |               | 1,150,409                       | 2,228             |                                 | 1,102,963         | 2,276                           |
| Options - USA  |               | 2,258,420                       | 4,847             |                                 | 2,442,771         | 5,136                           |
| Options - Canada                                     |               | 129,621                         | 297               |                                 | 111,444           | 266                             |
| Total options  |               | 2,388,041                       | 5,144             |                                 | 2,554,215         | 5,402                           |
| Total backlog  | \$            | 3,538,450                       | 7,372             | \$                              | 3,657,178         | 7,678                           |
|  |               |                                 |                   |                                 | \$                | 2,673,619                       |
|  |               |                                 |                   |                                 |                   | 6,325                           |

| Equivalent Units in Backlog                  | 26 Weeks Ended June 29, 2014 |         | 52 Weeks Ended December 29, 2013 |                      | 52 Weeks Ended December 30, 2012 |                      |
|--|------------------------------|---------|----------------------------------|----------------------|----------------------------------|----------------------|
|  | Firm orders                  | Options | Firm orders                      | Options              | Firm orders                      | Options              |
| Beginning of period                          | 2,276                        | 5,402   | 1,672 <sup>(4)</sup>             | 4,653 <sup>(5)</sup> | 1,476 <sup>(4)</sup>             | 5,621 <sup>(5)</sup> |
| New orders                                   | 461                          | 574     | 1,923                            | 3,356                | 882                              | 738                  |
| NABI acquired backlog                        | —                            | —       | 551                              | 608                  | —                                | —                    |
| Options exercised                            | 627                          | (627)   | 601                              | (601)                | 970                              | (970)                |
| Shipments                                    | (1,136)                      | —       | (2,191)                          | —                    | (1,656)                          | —                    |
| Removal of deferred order <sup>(4) (5)</sup> | —                            | —       | (280)                            | (1,520)              | —                                | —                    |
| Cancelled/expired                            | —                            | (205)   | —                                | (1,094)              | —                                | (736)                |
| End of period                                | 2,228                        | 5,144   | 2,276                            | 5,402                | 1,672 <sup>(4)</sup>             | 4,653 <sup>(5)</sup> |

The maximum term for a contract permitted by the Federal Transit Administration (“FTA”) is five years. Remaining options included in the total backlog will expire, if not exercised, as follows:

|               |       |
|---------------|-------|
| 2014 Q3       | 699   |
| 2014 Q4       | 453   |
| 2014          | 1,152 |
| 2015          | 957   |
| 2016          | 326   |
| 2017          | 570   |
| 2018          | 1,797 |
| 2019          | 342   |
| Total options | 5,144 |

- (1) Earnings from Operations, EBITDA and Adjusted EBITDA are not recognized earnings measures and do not have standardized meanings prescribed by IFRS. Therefore, Earnings from Operations, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. See “Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow” above. Management believes that Earnings from Operations, EBITDA and Adjusted EBITDA are useful supplemental measures in evaluating performance of NFI.
- (2) One equivalent unit or “EU” represents one 30-foot, 35-foot or 40-foot heavy-duty transit bus. One 60-foot articulated bus represents two equivalent units or “EUs”.
- (3) Finished goods are comprised of completed buses ready for delivery and bus deliveries in-transit.
- (4) Included in the Company’s total firm order backlog at the relevant time were 280 EUs under a major U.S. customer award. Based on discussions with this customer, it was uncertain whether any of these 280 EUs would enter the Company’s production schedule. Management removed these EUs from the backlog at December 29, 2013.
- (5) Included in the Company’s total option backlog at the relevant time were 1,520 option EUs under a major U.S. customer award. Based on discussions with this customer, it was uncertain whether any of these 1,520 option EUs would be exercised prior to their expected expiry. Management removed these EUs from the backlog at December 29, 2013.

**RECONCILIATION OF NET EARNINGS TO EBITDA AND ADJUSTED EBITDA**

Management believes that EBITDA and Adjusted EBITDA are important measures in evaluating the historical operating performance of the Company. However, EBITDA and Adjusted EBITDA are not recognized earnings measures under IFRS and do not have standardized meanings prescribed by IFRS. Accordingly, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Readers of this MD&A are cautioned that EBITDA and Adjusted EBITDA should not be construed as alternatives to net earnings or loss determined in accordance with IFRS as indicators of the Company's performance, or cash flows from operating activities as a measure of liquidity and cash flow. The Company defines and has computed EBITDA and Adjusted EBITDA as described under "Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow" above. The following tables reconcile net earnings or losses and cash flow from operations to EBITDA and Adjusted EBITDA based on the historical consolidated financial statements of the Company for the periods indicated.

| (Unaudited, US dollars in thousands)  | 13-Weeks<br>Ended<br>June 29,<br>2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 | 52-Weeks<br>Ended<br>June 29, 2014 | 52-Weeks<br>Ended<br>June 30, 2013 |
|---|---------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Net earnings  | \$ 3,563                              | \$ 1,684                           | \$ 9,047                           | \$ 5,197                           | \$ 30,611                          | \$ 10,649                          |
| Addback <sup>(1)</sup>  |                                       |                                    |                                    |                                    |                                    |                                    |
| Income taxes (recovered)  | 4,827                                 | (1,185)                            | 6,041                              | (1,556)                            | 15,453                             | 150                                |
| Finance cost  | 4,373                                 | 4,404                              | 7,679                              | 7,533                              | 14,492                             | 14,784                             |
| Amortization  | 8,131                                 | 6,537                              | 15,849                             | 12,829                             | 31,021                             | 25,234                             |
| Unrealized foreign exchange (gain)<br>loss on non-current monetary items              | (1,000)                               | 1,891                              | (620)                              | 2,116                              | (590)                              | 3,252                              |
| EBITDA <sup>(2)</sup>   | 19,894                                | 13,331                             | 37,996                             | 26,119                             | 90,987                             | 54,069                             |
| Costs associated with assessing<br>strategic and corporate initiatives <sup>(4)</sup> | —                                     | 3,253                              | —                                  | 4,383                              | 1,606                              | 4,956                              |
| Realized investment tax credits <sup>(5)</sup>  | 2,737                                 | 799                                | 3,725                              | 2,072                              | 9,788                              | 2,072                              |
| Non-recurring transitional costs<br>relating to business acquisitions <sup>(6)</sup>  | 162                                   | 582                                | 533                                | 767                                | 918                                | 767                                |
| Impairment loss on equipment and<br>intangible assets <sup>(7)</sup>                  | 3,919                                 | —                                  | 3,919                              | —                                  | 3,919                              | —                                  |
| Product rationalization costs <sup>(8)</sup>  | 96                                    | —                                  | 96                                 | —                                  | 96                                 | —                                  |
| Stock-based compensation  | 158                                   | 98                                 | 363                                | 98                                 | 564                                | 98                                 |
| Adjusted EBITDA <sup>(2)</sup>  | \$ 26,966                             | \$ 18,063                          | \$ 46,632                          | \$ 33,439                          | \$ 107,878                         | \$ 61,962                          |

**RECONCILIATION OF CASH FLOW TO EBITDA AND ADJUSTED EBITDA**

| (Unaudited, US dollars in thousands)   | 13-Weeks<br>Ended<br>June 29,<br>2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 | 52-Weeks<br>Ended<br>June 29, 2014 | 52-Weeks<br>Ended<br>June 30, 2013 |
|--|---------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Net cash generated by operations   | \$ 1,057                              | \$ 43,730                          | \$ 18,508                          | \$ 19,137                          | \$ 29,350                          | \$ 43,246                          |
| Addback <sup>(1)</sup>   |                                       |                                    |                                    |                                    |                                    |                                    |
| Changes in non-cash working capital items  | 18,864                                | (39,070)                           | 10,981                             | (15,613)                           | 49,582                             | (25,170)                           |
| Defined benefit funding  | —                                     | 2,282                              | 2,141                              | 4,322                              | 6,533                              | 9,124                              |
| Defined benefit expense  | (662)                                 | (647)                              | (1,323)                            | (1,304)                            | (2,797)                            | (2,181)                            |
| Interest paid  | 3,809                                 | 4,739                              | 7,636                              | 7,664                              | 10,921                             | 16,126                             |
| Realized investment tax credits  | (3,895)                               | (799)                              | (4,883)                            | (2,072)                            | (12,414)                           | (2,072)                            |
| Impairment loss on equipment and intangible assets                                 | (3,919)                               | —                                  | (3,919)                            | —                                  | (3,919)                            | —                                  |
| Stock-based compensation   | (158)                                 | (98)                               | (363)                              | (98)                               | (564)                              | (98)                               |
| Foreign exchange gain on cash held in foreign currency                             | 351                                   | 125                                | 379                                | 746                                | (175)                              | 2,799                              |
| Income taxes paid <sup>(3)</sup>   | 4,447                                 | 3,069                              | 8,839                              | 13,337                             | 14,470                             | 12,295                             |
| EBITDA <sup>(2)</sup>  | 19,894                                | 13,331                             | 37,996                             | 26,119                             | 90,987                             | 54,069                             |
| Costs associated with assessing strategic and corporate initiatives <sup>(4)</sup> | —                                     | 3,253                              | —                                  | 4,383                              | 1,606                              | 4,956                              |
| Realized investment tax credits <sup>(5)</sup>                                     | 2,737                                 | 799                                | 3,725                              | 2,072                              | 9,788                              | 2,072                              |
| Non-recurring transitional costs relating to business acquisitions <sup>(6)</sup>  | 162                                   | 582                                | 533                                | 767                                | 918                                | 767                                |
| Impairment loss on equipment and intangible assets <sup>(7)</sup>                  | 3,919                                 | —                                  | 3,919                              | —                                  | 3,919                              | —                                  |
| Product rationalization costs <sup>(8)</sup>                                       | 96                                    | —                                  | 96                                 | —                                  | 96                                 | —                                  |
| Stock-based compensation   | 158                                   | 98                                 | 363                                | 98                                 | 564                                | 98                                 |
| Adjusted EBITDA <sup>(2)</sup>   | \$ 26,966                             | \$ 18,063                          | \$ 46,632                          | \$ 33,439                          | \$ 107,878                         | \$ 61,962                          |

- (1) Addback items are derived from the historical financial statements of the Company.
- (2) EBITDA and Adjusted EBITDA are not recognized earnings measures and do not have standardized meanings prescribed by IFRS. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. See “Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow” above. Management believes that EBITDA and Adjusted EBITDA are useful supplemental measures in evaluating performance of the Company.
- (3) As a result of the Company’s multinational corporate structure, income taxes paid are subject to high degrees of volatility due to the mix of U.S. and Canadian earnings. Income taxes paid in 2013 YTD included a \$8.0 million payment of NFI’s 2012 Canadian income tax liability and installment payments as compared to no required installment payments in 2014 YTD.
- (4) Normalized to exclude non-recurring expenses related to the costs of assessing strategic and corporate initiatives, including amounts related to acquiring Orion parts business and NABI.
- (5) The Company recognizes ITCs in Adjusted EBITDA only during the period in which they are applied against income taxes payable. During 2014 Q2 LTM the Company recognized \$12,414 of ITCs, however a related contractual liability exists to a customer of \$2,626.
- (6) Normalized to exclude non-recurring expenses related to the transitional costs related to recently acquired Orion parts business and NABI.
- (7) On June 24, 2014 the Company announced its plan to rationalize to a common Xcelsior® platform for all heavy-duty and BRT transit buses. As a result, production of NABI Bus LFW and BRT models will be phased out in 2015 and as such an impairment charge on equipment and intangible assets was recorded.
- (8) Normalized to exclude non-recurring expenses related the plan to rationalize NABI Bus models to a common Xcelsior® platform.

## SUMMARY OF FREE CASH FLOW

Management uses Free Cash Flow as a non-IFRS measure to evaluate the Company's operating performance and liquidity and to assess New Flyer's ability to pay dividends to common shareholders, service debt, and meet other payment obligations.

The Company generates its Free Cash Flow from operations, and management expects this will continue to be the case for the foreseeable future. Net cash flows generated by operating activities are significantly impacted by changes in non-cash working capital. The Company uses the Revolver to finance working capital and therefore has excluded the impact of working capital in calculating Free Cash Flow. As well, net cash generated by operating activities and net earnings are significantly affected by the volatility of current income taxes, which in turn produces temporary fluctuations in the determination of Free Cash Flow.

The following is a reconciliation of net cash generated by operating activities (an IFRS measure) to Free Cash Flow (a non-IFRS measure) based on the Company's historical financial statements. See "Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow".

| (Unaudited, US dollars in thousands)   | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 | 52-Weeks<br>Ended<br>June 29, 2014 | 52-Weeks<br>Ended<br>June 30, 2013 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Net cash generated by operations   | \$ 1,057                           | \$ 43,730                          | \$ 18,508                          | \$ 19,137                          | \$ 29,350                          | \$ 43,246                          |
| Changes in non-cash working capital items <sup>(3)</sup>                           | 18,864                             | (39,070)                           | 10,981                             | (15,613)                           | 49,582                             | (25,170)                           |
| Interest paid <sup>(3)</sup>   | 3,809                              | 4,739                              | 7,636                              | 7,664                              | 10,921                             | 16,126                             |
| Interest expense <sup>(3)</sup>  | (3,447)                            | (2,959)                            | (6,527)                            | (5,888)                            | (12,245)                           | (12,519)                           |
| Income taxes paid <sup>(3)</sup>   | 4,447                              | 3,069                              | 8,839                              | 13,337                             | 14,470                             | 12,295                             |
| Current income tax expense <sup>(3)</sup>  | (7,002)                            | (3,685)                            | (10,409)                           | (8,173)                            | (26,085)                           | (14,787)                           |
| Principal portion of finance lease payments  | (319)                              | (506)                              | (677)                              | (1,214)                            | (1,466)                            | (2,358)                            |
| Cash capital expenditures <sup>(8)</sup>   | (1,505)                            | (2,009)                            | (4,795)                            | (2,321)                            | (16,310)                           | (2,987)                            |
| Non-recurring transitional costs relating to business acquisitions <sup>(9)</sup>  | 162                                | 582                                | 533                                | 767                                | 918                                | 767                                |
| Costs associated with assessing strategic and corporate initiatives <sup>(7)</sup> | —                                  | 3,253                              | —                                  | 4,383                              | 1,606                              | 4,956                              |
| Product rationalization costs <sup>(11)</sup>                                      | 96                                 | —                                  | 96                                 | —                                  | 96                                 | —                                  |
| Defined benefit funding <sup>(4)</sup>   | —                                  | 2,282                              | 2,141                              | 4,322                              | 6,533                              | 9,124                              |
| Defined benefit expense <sup>(4)</sup>   | (662)                              | (647)                              | (1,323)                            | (1,304)                            | (2,797)                            | (2,181)                            |
| Realized investment tax credits <sup>(10)</sup>                                    | (1,158)                            | —                                  | (1,158)                            | —                                  | (2,626)                            | —                                  |
| Foreign exchange gain on cash held in foreign currency <sup>(5)</sup>              | 351                                | 125                                | 379                                | 746                                | (175)                              | 2,799                              |
| <b>Free Cash Flow (US\$)<sup>(1)</sup></b>   | <b>14,693</b>                      | <b>8,904</b>                       | <b>24,224</b>                      | <b>15,843</b>                      | <b>51,772</b>                      | <b>29,311</b>                      |
| U.S. exchange rate <sup>(2)</sup>  | 1.0853                             | 1.0341                             | 1.0946                             | 1.0256                             | 1.0691                             | 1.0376                             |
| <b>Free Cash Flow<sup>(1)</sup> (C\$)</b>  | <b>15,946</b>                      | <b>9,208</b>                       | <b>26,515</b>                      | <b>16,249</b>                      | <b>55,351</b>                      | <b>30,414</b>                      |
| Free Cash Flow per Share (C\$) <sup>(6)</sup>                                      | 0.2875                             | 0.1842                             | 0.4780                             | 0.3359                             | 0.9979                             | 0.6781                             |
| <b>Declared dividends on Shares (C\$)</b>  | <b>8,113</b>                       | <b>7,511</b>                       | <b>16,225</b>                      | <b>14,482</b>                      | <b>32,449</b>                      | <b>28,480</b>                      |
| Declared dividend per Share (C\$) <sup>(6)</sup>                                   | \$ 0.1463                          | \$ 0.1503                          | \$ 0.2925                          | \$ 0.2994                          | \$ 0.5850                          | \$ 0.6350                          |

(1) Free Cash Flow is not a recognized measure under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, Free Cash Flow may not be comparable to similar measures presented by other issuers. See "Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow" above.

(2) U.S. exchange rate (C\$ per US\$) is the weighted average exchange rate applicable to the payment of distributions for the period.

(3) Changes in non-cash working capital are excluded from the calculation of Free Cash Flow as these temporary fluctuations are managed through the Revolver which is available for use to fund general corporate requirements including working capital requirements, subject to borrowing capacity restrictions. Changes in non-cash working capital are presented on the consolidated statements of cash flows net of interest and incomes taxes paid.

- (4) The cash effect of the difference between the defined benefit expense and funding is included in the determination of cash from operating activities. This cash effect is excluded in the determination of Free Cash Flow as management believes that the defined benefit expense amount provides a more appropriate measure, as the defined benefit funding can be impacted by special payments to reduce the unfunded pension liability.
- (5) Foreign exchange gain (loss) on cash held in foreign currency is excluded in the determination of cash from operating activities under IFRS; however, because it is a cash item, management believes it should be included in the calculation of Free Cash Flow.
- (6) Per Share calculations for Free Cash Flow (C\$) and declared dividends (C\$) are determined by dividing these amounts by the total of all issued and outstanding Shares using the weighted average over the period. The weighted average number of Shares outstanding for 2014 Q2 was 55,470,705, 55,468,846 for 2014 YTD and 55,467,875 for 2014 Q2 LTM. The weighted average number of Shares outstanding for 2013 Q2 was 49,981,776, 48,371,210 for 2013 YTD and 44,851,324 for 2013 Q2 LTM.
- (7) Normalized to exclude non-recurring expenses related to the costs of assessing strategic and corporate initiatives.
- (8) Cash capital expenditures do not include property, plant and equipment leased or purchased using funds borrowed from the delayed draw portion of the Credit Facility or included in the Orion parts business acquisition.
- (9) Normalized to exclude non-recurring expenses related to the transitional costs related to recently acquired Orion parts business and NABI.
- (10) The Company recognizes ITCs in Adjusted EBITDA only during the period in which they are applied against income taxes payable. During 2014 Q2 LTM the Company recognized \$12,414 of ITCs, however a related contractual liability exists to a third party of \$2,626.
- (11) Normalized to exclude non-recurring expenses related the plan to rationalize NABI Bus models to a common Xcelior® platform.

#### **Dividend Policy**

NFI's board of directors (the "Board") intends to have a common share dividend policy that is consistent with New Flyer's financial performance and the desire to retain certain cash flows to support the ongoing requirements of the business and to provide the financial flexibility to pursue revenue diversification and growth opportunities.

On August 8, 2012, the Board set an annual dividend rate of C\$0.585 per Share effective for all dividends declared after that date. The Board expects to maintain these dividends on a monthly basis although such distributions are not assured.

Compared to other common share issuers listed on the TSX, the Board believes this level of dividend provides investors with an attractive level of income.

#### **Currency Impact on the Company's Reported Results**

The Financial Statements are presented in U.S. dollars. New Flyer operates in both the United States and Canada and, as a result, its combined reported results are impacted by fluctuations in the exchange rate between the Canadian dollar ("CAD") and the U.S. dollar ("USD"). However, the impact of changes in foreign exchange rates on the Company's reported results differs over time depending on whether the Company is generating a net cash inflow or outflow of Canadian dollars.

The impact of the weakening Canadian dollar against the U.S. dollar is largely dependent on the Company's revenue mix by currency as operating costs denominated in Canadian dollars have been relatively stable. CAD denominated costs do not vary unless production is shifted between plants while the revenue exposure is based on the amount of CAD contracts that are recognized as revenue. Most of the material cost is already denominated in USD; however, labour cost as well as manufacturing overheads and selling, general and administrative costs have significant CAD denominated costs. During 2014 YTD, approximately 85% of revenue was USD denominated and approximately 15% was CAD denominated. As at June 29, 2014, the backlog consisted of firm CAD orders of 298 EUs (\$123 million U.S. equivalent) representing approximately 10.7% of firm orders. CAD options at June 29, 2014 totaled 297 EUs (\$130 million U.S. equivalent) representing approximately 5.4% of the option backlog. A portion of the Canadian based revenue eroded due to weakening Canadian dollar against the U.S. dollar, offset by the foreign exchange gain on CAD expenses. For new business, management factors the current exchange rate into pricing decisions to mitigate the impact on Canadian orders.

During 2014 Q2, the Company's CAD dollars inflows approximated its CAD dollar outflows. Based on production plans as of the date hereof, management expects the Company to generate a net CAD inflow during Fiscal 2014. The expectation is based on current production plans and may change based on the amount of Canadian contracts delivered during the second half of Fiscal 2014. As a matter of policy, New Flyer enters into foreign exchange forward contracts to protect the expected net CAD exposure from exchange fluctuation. Management's strategy is to mitigate foreign currency exposure based on net cash flow rather than Adjusted EBITDA.

The settlements of the forward contracts were recorded as realized foreign exchange gains or losses in net earnings for the reported periods as the Company has elected not to use hedge accounting. During 2014 Q2, the Company recorded realized foreign exchange loss of \$0.2 million (2013 Q2: \$0.04 million loss).

At June 29, 2014, the Company had \$14.0 million of foreign exchange forward contracts to sell Canadian dollars and \$4.0 million of foreign exchange forward contracts to buy Euros that range in expiry dates from July 2014 to December 2014. As well, the Company purchased a foreign exchange forward plus instrument that expires February 2015, whereby if USD/CAD foreign exchange rate is below 1.0590, NFI will be obligated to purchase the U.S. equivalent of C\$15.0 million at 1.0895, however if USD/CAD rate is above 1.0590, NFI may exercise its USD call option to purchase the U.S. equivalent of C\$15.0 million at 1.0895. The related liability of \$0.3 million (December 2013: \$0.7 million) is recorded on the interim condensed consolidated statements of financial position as a current derivative financial instruments liability and the corresponding change in the fair value of the foreign exchange forward contracts is recorded in the interim consolidated statements of net earnings and total comprehensive income.

#### Fiscal and Interim Periods

The Company's fiscal year is divided in quarters. The following table summarizes the number of calendar and available production weeks in the fiscal and interim periods presented for the Company:

|             | Period from<br>December 30, 2013<br>to December 28, 2014<br>("Fiscal 2014") |                           |                                       | Period from<br>December 31, 2012<br>to December 29, 2013<br>("Fiscal 2013") |                           |                                       |
|-------------|---|---------------------------|---------------------------------------|---|---------------------------|---------------------------------------|
|             | Period End Date   | # of<br>Calendar<br>Weeks | # of Available<br>Production<br>Weeks | Period End Date   | # of<br>Calendar<br>Weeks | # of Available<br>Production<br>Weeks |
| Quarter 1   | March 30, 2014  | 13                        | 12.5                                  | March 31, 2013  | 13                        | 12.4                                  |
| Quarter 2   | June 29, 2014   | 13                        | 12.7                                  | June 30, 2013   | 13                        | 12.8                                  |
| Quarter 3   | September 28, 2014  | 13                        | 12.3                                  | September 29, 2013  | 13                        | 12.4                                  |
| Quarter 4   | December 28, 2014   | 13                        | 12.0                                  | December 29, 2013   | 13                        | 12.0                                  |
| Fiscal year | December 28, 2014   | 52                        | 49.5                                  | December 29, 2013   | 52                        | 49.6                                  |

An available production week equals five days of production, excluding any statutory holidays.



## Results of Operations

The Company's operations are divided into two business segments: bus manufacturing operations and aftermarket operations. The discussion below with respect to revenue, operating costs and expenses and Earnings from Operations has been divided between the bus manufacturing and aftermarket operations segments.

| (U.S. dollars in thousands)                    | 2014 Q2<br>(13-Weeks) | 2013 Q2<br>(13-Weeks)<br>(*restated) | 2014 YTD<br>(26-Weeks) | 2013 YTD<br>(26-Weeks)<br>(*restated) |
|--|-----------------------|--------------------------------------|------------------------|---------------------------------------|
| Bus Manufacturing Revenue                      | \$ 265,321            | \$ 215,230                           | \$ 516,720             | \$ 423,025                            |
| Aftermarket Revenue                            | 80,653                | 51,346                               | 153,629                | 88,686                                |
| Total Revenue                                  | \$ 346,484            | \$ 266,576                           | \$ 670,349             | \$ 511,711                            |
| Earnings from Operations <sup>(1)</sup>        | 15,682                | 6,794                                | 26,066                 | 13,290                                |
| Earnings before finance costs and income taxes | 12,763                | 4,903                                | 22,767                 | 11,174                                |
| Earnings before income taxes                   | 8,390                 | 499                                  | 15,088                 | 3,641                                 |
| Net earnings for the period                    | 3,563                 | 1,684                                | 9,047                  | 5,197                                 |

(\*) Revenue for 2013 Q2 has been restated for a correction of an error relating to revenue recognition of extended warranties. The correction also equally decreased cost of sales and therefore did not have an impact on Earnings from Operations, net earnings, assets, liabilities or ending deficit of the Company. For details, see footnote on page 9 of this MD&A and note 2.5 of the Financial Statements.

(1) "Earnings from Operations" is not a recognized earnings measure and does not have a standardized meaning prescribed by IFRS. Therefore, Earnings from Operations may not be comparable to similar measures presented by other issuers. See "Definitions of Earnings from Operations, EBITDA, Adjusted EBITDA and Free Cash Flow" above. Management believes that Earnings from Operations is a useful supplemental measure in evaluating performance of NFI.

### Revenue

The Company generated consolidated revenue of \$346.5 million for 2014 Q2, an increase of 30.0% compared to consolidated revenue for 2013 Q2 of \$266.6 million, and consolidated revenue for 2014 YTD of \$670.3 million, an increase of 31.0% from consolidated revenue for 2013 YTD of \$511.7 million. The revenue growth primarily resulted from business acquisitions in Fiscal 2013 and the CTA midlife overhaul program.

Revenue from bus manufacturing operations for 2014 Q2 was \$265.8 million, an increase of 23.5% from \$215.2 million in 2013 Q2, and revenue of \$516.7 million for 2014 YTD increased 22.1% from \$423.0 million for 2013 YTD. The increase in 2014 Q2 revenue primarily resulted from a 19.0% increase in total bus deliveries of 582 EUs in 2014 Q2 compared to 2013 Q2 deliveries of 489 EUs and a 3.8% increase in average selling price per EU in 2014 Q2 compared to 2013 Q2. The average selling price per EU in 2014 Q2 was \$456.8 thousand which increased compared to \$440.1 thousand in 2013 Q2. Similarly, bus deliveries of 1,136 EUs in 2014 YTD increased 16.0% compared to 979 EUs in 2013 YTD and the average selling price per EU in 2014 YTD of \$454.9 thousand increased 5.3% from \$432.1 thousand in 2013 YTD. The increase in average selling price is the result of changes in the product sales mix, which included more sales of hybrid buses and fewer articulated buses. The average selling price can be volatile when comparing two fiscal quarters as a result of sales mix. The increased deliveries primarily were as a result of including NABI Bus deliveries effective June 21, 2013. However, WIP at the end of 2014 Q2, which now includes 15 MiDi<sup>®</sup> buses, increased by 60 EUs over the WIP at the end of 2014 Q1. The 60 EUs that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries on these contracts by year end.

Revenue from aftermarket operations in 2014 Q2 was \$80.7 million, an increase of 57.1% compared to \$51.3 million in 2013 Q2. Revenue from aftermarket operations for 2014 YTD was \$153.6 million, an increase of 73.2% compared to \$88.7 million in 2013 YTD. The increase in aftermarket operations revenue is primarily a result of increased volumes as a result of incremental revenue from the CTA midlife overhaul program, the Orion parts business and the NABI Parts business.

### Cost of sales

The consolidated cost of sales for 2014 Q2 of \$309.3 million increased by 28.0% from 2013 Q2 consolidated cost of sales of \$241.6 million. 2014 YTD consolidated cost of sales of \$603.1 million increased by 29.5% from 2013 YTD of \$465.6 million. The increased percentage of cost of sales is consistent with the related increase in revenue during 2014 Q2 and 2014 YTD.

Costs of sales from bus manufacturing operations consist of direct contract costs and manufacturing overhead. The cost of sales from bus manufacturing operations for 2014 Q2 was \$245.9 million (92.5% of revenue from bus manufacturing operations) compared to \$201.8

million (93.8% of revenue from bus manufacturing operations) in 2013 Q2, an increase of 21.9%. This increase in cost of sales primarily relates to 19.0% more deliveries in 2014 Q2. The cost of sales from bus manufacturing operations of \$483.6 million in 2014 YTD increased by 21.7% as compared to \$397.5 million in 2013 YTD. This increase in cost of sales primarily relates to 16.0% more deliveries in 2014 YTD as compared to 2013 YTD and a product sales mix with a higher average cost of sales when comparing the two periods.

The cost of sales from aftermarket operations was \$63.4 million (78.6% of aftermarket operations revenue) in 2014 Q2 which increased 59.3% compared to \$39.8 million (77.6% of aftermarket operations revenue) in 2013 Q2. During 2014 YTD, cost of sales from aftermarket operations was \$119.5 million (77.8% of aftermarket operations revenue) as compared to \$68.1 million (76.8% of aftermarket operations revenue) in 2013 YTD, representing an increase of 75.5%, primarily as a result of the increase in sales volumes.

***Selling, general and administrative costs and other operating expenses (“SG&A”)***

The consolidated SG&A for 2014 Q2 of \$21.2 million increased 15.3% compared with \$18.4 million in 2013 Q2. Consolidated SG&A for 2014 YTD were \$40.0 million which increased 20.0% compared to \$33.3 million in 2013 YTD. The increase in 2014 YTD SG&A is primarily a result of the addition of NABI and incremental costs to market and the start-up manufacturing costs of MiDi®. The SG&A for 2013 YTD also included \$4.3 million of incremental costs to explore and assess strategic and corporate initiatives.

***Realized foreign exchange loss/gain***

In 2014 Q2, the Company recognized a net realized loss of \$0.4 million compared with a net realized gain of \$0.2 million in 2013 Q2. Similarly, in 2014 YTD the Company recognized a net realized loss of \$1.2 million as compared with a net realized gain of \$0.5 million in 2013 YTD. During 2014 YTD, the Company experienced a greater amount of unfavourable settlements of foreign exchange contracts which resulted in an increase of realized foreign exchange losses as compared to 2013 YTD.

***Earnings from operations***

Consolidated earnings from operations for 2014 Q2 in the amount of \$15.7 million (4.5% of revenue) increased 130.8% compared to earnings from operations in 2013 Q2 of \$6.8 million (2.6% of revenue). 2014 YTD consolidated earnings from operations were \$26.1 million (3.9% of revenue), which represents a 96.1% increase as compared to \$13.3 million (2.6% of revenue) in 2013 YTD.

The earnings from bus manufacturing operations (including amortization and depreciation) for 2014 Q2 was \$3.9 million (1.5% of bus manufacturing revenue), compared to earnings of \$0.1 million for 2013 Q2 (0.1% of bus manufacturing revenue). The decreased earnings during 2013 Q2 are primarily a result of \$3.3 million of costs associated with assessing strategic and corporate initiatives. 2014 YTD earnings from bus manufacturing operations of \$3.6 million (0.7% of revenue) increased compared to \$1.4 million (0.3% of revenue) in 2013 YTD. When reviewing performance of the bus manufacturing operations, it is important to consider that corporate overhead costs are allocated fully to the bus business unit.

The earnings from aftermarket operations of \$11.8 million (14.6% of aftermarket revenue) in 2014 Q2 increased 76.1% compared to 2013 Q2 earnings of \$6.7 million (13.0% of aftermarket revenue). 2014 Q2 earnings from aftermarket operations increased primarily due to the contribution from the NABI Parts operations and by the CTA midlife overhaul program. The percentage of revenue was positively impacted by improved market fundamentals and the benefits to the product mix that has resulted from a far broader portfolio of services and parts offerings to customers partially offset by lower margins on CTA midlife overhaul program. In 2014 YTD, the earnings from aftermarket operations were \$22.5 million (14.7% of aftermarket revenue), compared to \$11.9 million (13.4% of aftermarket revenue) in 2013 YTD.

***Unrealized foreign exchange gain/loss***

The Company has recognized a net unrealized foreign exchange gain/loss consisting of the following:

| (Unaudited, U.S. dollars in thousands)                          | 2014 Q2    | 2013 Q2  | 2014 YTD | 2013 YTD |
|---|------------|----------|----------|----------|
| Unrealized (gain) loss on forward foreign exchanges contracts   | \$ (78)    | \$ 1,384 | \$ (446) | \$ 1,368 |
| Unrealized (gain) loss on other non-monetary assets/liabilities | (922)      | 507      | (174)    | 748      |
|   | \$ (1,000) | \$ 1,891 | \$ (620) | \$ 2,116 |

### **Earnings before interest and income taxes (“EBIT”)**

In 2014 Q2, the Company recorded EBIT of \$12.8 million compared to EBIT of \$4.9 million in 2013 Q2. The EBIT recorded during 2014 Q2 has increased primarily as a result of acquiring NABI on June 21, 2013. EBIT has been impacted by non-cash and non-recurring items as follows:

| (Unaudited, U.S. dollars in thousands)                              | 2014 Q2   | 2013 Q2   | 2014 YTD  | 2013 YTD  |
|---|-----------|-----------|-----------|-----------|
| Non-cash and non-recurring charges (recovery):                      |           |           |           |           |
| Costs associated with assessing strategic and corporate initiatives | \$ 96     | \$ 3,253  | \$ 96     | \$ 4,383  |
| Unrealized foreign exchange (gain) loss                             | (1,000)   | 1,891     | (620)     | 2,116     |
| Stock-based compensation  | 158       | 98        | 363       | 98        |
| Impairment loss on equipment and intangible assets <sup>(*)</sup>   | 3,919     | —         | 3,919     | —         |
| Non-recurring transitional costs relating to business acquisitions  | 162       | 582       | 533       | 767       |
| Amortization  | 8,131     | 6,537     | 15,849    | 12,829    |
| Total non-cash and non-recurring charges:                           | \$ 11,466 | \$ 12,361 | \$ 20,140 | \$ 20,193 |

(\*) On June 24, 2014 the Company announced its plan to rationalize to a common Xcelsior® platform for all heavy-duty and BRT transit buses. As a result, production of NABI Bus LFW and BRT models will be phased out, with the Anniston, Alabama facility expected to transition to Xcelsior in the second half of 2015. Management carried out a review of the recoverable amount of NABI Bus related assets. The review led to the recognition of an impairment loss of \$3.8 million relating to the NABI Bus trade name. Management also identified \$0.1 million of NABI Bus related equipment that no longer meets the definition of an asset and has been fully written-off. The total impairment loss of \$3.9 million has been included in net earnings.

Absent these non-cash charges/recoveries, the 2014 Q2 EBIT would have been \$24.3 million compared to \$17.3 million in 2013 Q2.

### **Finance costs**

The finance costs for 2014 Q2 were \$4.4 million, which was consistent when compared to \$4.4 million in 2013 Q2. The finance costs for 2014 YTD of \$7.7 million increased compared to \$7.5 million in 2013 YTD, primarily as a result of the \$20 million increase in Term Credit Facility borrowed on June 21, 2013.

### **Earnings before income taxes (“EBT”)**

EBT for 2014 Q2 of \$8.4 million increased compared to EBT of \$0.5 million in 2013 Q2 and the EBT for 2014 YTD of \$15.1 million improved compared to EBT of \$3.6 million in 2013 YTD. The difference in the EBT between these periods results from the increased earnings from operations offset by the impairment loss noted above.

### **Income tax expense**

The income tax expense for 2014 Q2 was \$4.8 million, consisting of \$7.0 million of current income tax expense and \$2.2 million of deferred income tax expense recovered. In comparison, the income tax expense recovered for 2013 Q2 was \$1.2 million, which consisted of \$3.7 million of current income tax expense and \$4.9 million of deferred income tax expense recovered.

The income tax expense for 2014 YTD was \$6.0 million, consisting of \$10.4 million of current income tax expense and \$4.4 million of deferred income tax expense recovered. In comparison, the income tax recovered for 2013 YTD was \$1.6 million, consisting of \$8.2 million of current income tax expense and \$9.7 million of deferred income tax expense recovered.

### **Net earnings**

The Company reported net earnings of \$3.6 million in 2014 Q2, which increased compared to net earnings of \$1.7 million in 2013 Q2 and 2014 YTD net earnings of \$9.0 million increased compared to 2013 YTD net earnings of \$5.2 million. The increased net earnings in 2014 Q2 and 2014 YTD is primarily as a result of increase in Earnings from Operations offset by increased income taxes and impairment loss.

The Company's net earnings per Share in 2014 Q2 were \$0.06, a 100.0% increase from net earnings per Share of \$0.03 generated during 2013 Q2. The net earnings per Share in 2014 YTD were \$0.16, a 45.5% increase from net earnings per Share of \$0.11 generated during 2013 YTD.

### **Cash Flow**

The cash flows of the Company are summarized as follows:

| (Unaudited, U.S. dollars in thousands)  | 2014 Q2    | 2013 Q2     | 2014 YTD   | 2013 YTD     |
|---|------------|-------------|------------|--------------|
| Cash generated by operating activities before non-cash working capital items and interest and income taxes paid | \$ 28,177  | \$ 12,468   | \$ 45,964  | \$ 24,525    |
| Interest paid   | (3,809)    | (4,739)     | (7,636)    | (7,664)      |
| Income taxes paid   | (4,447)    | (3,069)     | (8,839)    | (13,337)     |
| Net cash earnings   | 19,921     | 4,660       | 29,489     | 3,524        |
| Changes in non-cash working capital items   | (18,864)   | 39,070      | (10,981)   | 15,613       |
| Cash flow from operating activities   | 1,057      | 43,730      | 18,508     | 19,137       |
| Cash flow (used in) from financing activities   | (9,428)    | 43,300      | (21,032)   | 94,851       |
| Cash flow used in investing activities  | \$ (1,842) | \$ (77,314) | \$ (5,437) | \$ (109,443) |

### **Cash flows from operating activities**

The 2014 Q2 net operating cash inflow of \$1.1 million is the result of \$19.9 million of net cash earnings offset by an increase in non-cash working capital of \$18.8 million and compared to 2013 Q2 net operating cash inflow of \$43.7 million which was the result of a \$39.1 million decrease in non-cash working capital and \$4.7 million of net cash earnings. The cash outflow of \$18.3 million from non-cash working capital changes during 2014 Q2 is primarily due to increased inventory and decreased accounts payables partially offset by reduced accounts receivables. The non-cash working capital changes during 2013 Q2 are primarily a result of acquiring NABI's working capital during the period. At June 29, 2014, there were 60 EUs in WIP that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries on these contracts by year end.

### **Cash flow from financing activities**

The Company's financing activities resulted in a net cash outflow of \$9.4 million and a cash inflow \$43.3 million for 2014 Q2 and 2013 Q2, respectively. The cash outflow during 2014 Q2 primarily relates to \$7.4 million of dividend payments. The cash inflow during 2013 Q2 primarily relates to \$61.5 million of cash received from the proceeds of Shares issued to Marcopolo (net of share issuance costs) offset by the net repayment of \$10.6 million of the Revolver and \$7.1 million for dividends.

### **Cash flow from investing activities**

2014 Q2 investing activities resulted in a net cash outflow of \$1.8 million compared to \$77.3 million in 2013 Q2. 2014 Q2 cash outflows were primarily as a result of property, plant and equipment ("PPE") expenditures shown below. In comparison, for 2013 Q2 the Company invested \$75.0 million to acquire NABI. The composition of the PPE capital expenditures was as follows:

| (Unaudited, U.S. dollars in thousands)                                  | 2014 Q2  | 2013 Q2  | 2014 YTD | 2013 YTD |
|---|----------|----------|----------|----------|
| PPE expenditures  | \$ 3,219 | \$ 2,622 | \$ 6,809 | \$ 3,635 |
| Less PPE expenditures funded as part of Orion parts business            | —        | —        | —        | (394)    |
| Less PPE expenditures funded by capital leases                          | (1,418)  | (331)    | (1,485)  | (423)    |
| Acquisition of PPE reported on statement of cash flows                  | 1,801    | 2,291    | 5,324    | 2,818    |
| Less PPE expenditures funded by senior term loan for asset acquisitions | (296)    | (282)    | (529)    | (497)    |
| Cash PPE expenditure  | \$ 1,505 | \$ 2,009 | \$ 4,795 | \$ 2,321 |

\*Term loan was required to be drawn in fiscal 2012. The proceeds have been applied to PPE expenditures during 2014 YTD and 2013 YTD.

## **Liquidity and Capital Resources**

Liquidity risk arises from the Company's financial obligations and in the management of its assets, liabilities and capital structure. This risk is managed by regularly evaluating the liquid financial resources to fund current and long-term obligations and to meet the Company's capital commitments in a cost-effective manner.

The main factors that affect liquidity include sales mix, production levels, cash production costs, working capital requirements, capital expenditure requirements, scheduled repayments of long-term debt obligations, funding requirements of the Company's pension plans, credit capacity and expected future debt and equity capital market conditions.

The Company's liquidity requirements are met through a variety of sources, including: cash on hand, cash generated from operations, the Credit Facility, leases, and debt and equity capital markets.

As a result of the contract solicitation process in the bus manufacturing industry, bus purchase contracts are customer specific and contain varied terms and conditions, including terms relating to the timing of payments made under such contracts. As such, the timing of the payments of the Company's accounts receivable is not always consistent or predictable, which may result in the Company drawing on its Revolver in order to meet its working capital requirements.

The Company generated Free Cash Flow of C\$26.5 million during 2014 YTD as compared to C\$16.2 million in 2013 YTD. The Company declared dividends in 2014 YTD of C\$16.2 million as compared to C\$14.5 million in 2013 YTD. Management believes that sufficient Free Cash Flow will be generated to maintain the current dividend rate. The Company has paid dividends to shareholders for 105 consecutive months since the Company's initial public offering in August 2005.

During 2014 Q2, the Company decreased its cash by \$9.9 million, partially due to increased investment in non-cash working capital items, such as increased inventories and decreased accounts payables partially offset by decreased accounts receivables. There were 60 EUs in WIP at June 29, 2014 that were not delivered as a result of delayed customer inspection and acceptance in respect of a few low margin contracts. Management expects to recover deliveries on these contracts by year end.

The June 29, 2014 liquidity position of \$67.4 million is comprised of available cash of \$4.3 million and \$63.1 million available under the Company's Revolver as compared to a liquidity position of \$69.2 million at December 29, 2013. As at June 29, 2014, there were \$30.0 million of direct borrowings and \$21.9 million of outstanding letters of credit related to the \$115.0 million Revolver.

Management believes that the current liquidity funds, together with the cash generated from the Company's operating activities will provide the Company with sufficient liquidity and capital resources to meet its current financial obligations as they come due, as well as provide funds for its financing requirements, capital expenditures, dividend payments and other needs for the foreseeable future.

There are certain financial covenants under the Credit Facility that must be maintained. These financial covenants include an interest coverage ratio and total leverage ratio. Under the Credit Facility the Debentures are treated as equity for purposes of calculating the total leverage ratio. At June 29, 2014, the Company was in compliance with the ratios.

The results of the financial covenants tests as of such date are as follows:

|   | June 29, 2014 | March 30, 2014 | December 29, 2013 |
|---|---------------|----------------|-------------------|
| Total Leverage Ratio (must be less than 3.25)       | 1.69          | 1.67           | 1.67              |
| Interest Coverage Ratio (must be greater than 3.00) | 8.81          | 8.72           | 9.21              |

## **Interest rate risk**

In connection with the Credit Facility, the Company has an interest rate swap designed to hedge floating rate exposure for the term of the Credit Facility on \$142 million of drawn term loan. The current interest rate swap fixes the interest rate at 1.46% plus the applicable interest margin until April 2017. The fair value of the interest rate swap liability of \$2.6 million at June 29, 2014 (December 29, 2013: \$2.9 million) was recorded on the interim condensed consolidated statements of financial position as a derivative financial instruments liability and the change in fair value has been recorded as finance costs for the reported period.

## Credit risk

Financial instruments which potentially subject the Company to credit risk and concentrations of credit risk consist principally of cash, accounts receivable and derivatives. Management has assessed that the credit risk associated with accounts receivable is mitigated by the significant proportion for which the counterparties are well established transit authorities. Additionally, the U.S. federal government funds a substantial portion of U.S. customer payments - up to 80% of the capital cost of new buses typically comes from the FTA, while the remaining 20% comes from state and municipal sources. The maximum exposure to the risk of credit for accounts receivables corresponds to their book value. Historically, the Company has experienced nominal bad debts as a result of the customer base being principally comprised of municipal and other local transit authorities.

The carrying amount of accounts receivable is reduced through the use of an allowance account and the amount of the loss is recognized in the earnings statement within SG&A. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts receivable. Subsequent recoveries of amounts previously written off are credited against SG&A in the interim condensed consolidated statements of net earnings and total comprehensive income.

The following table details the aging of the Company's receivables and related allowance for doubtful accounts:

|  | June 29, 2014 | December 29, 2013 |
|--|---------------|-------------------|
| Current, including holdbacks             | \$ 129,613    | \$ 213,101        |
| <u>Past due amounts but not impaired</u> |               |                   |
| 1 - 60 days                              | 14,670        | 16,370            |
| Greater than 60 days                     | 2,529         | 1,270             |
| Less: allowance for doubtful accounts    | (505)         | (426)             |
| Total accounts receivables, net          | \$ 146,307    | \$ 230,315        |

The counterparties to the Company's derivatives are chartered Canadian banks. The Company could be exposed to loss in the event of non-performance by the counterparty. However, credit ratings and concentration of risk of the financial institutions are monitored on a regular basis.

## Commitments and Contractual Obligations

### Commitments

The following table outlines the Company's maturity analysis of the undiscounted cash flows of certain non-current financial liabilities and leases as at June 29, 2014:

| U.S. dollars in thousands   | Total      | 2014      | 2015      | 2016      | 2017       | 2018     | Post 2018 |
|-----------------------------|------------|-----------|-----------|-----------|------------|----------|-----------|
| Senior term loan            | \$ 155,750 | \$ 2,500  | \$ 5,000  | \$ 5,000  | \$ 143,250 | \$ —     | \$ —      |
| Convertible debentures      | 77,143     | 2,030     | 4,060     | 4,060     | 66,993     | —        | —         |
| Other long-term liabilities | 10,454     | 1,000     | 3,000     | 2,250     | 1,000      | 1,000    | 2,204     |
| Finance leases              | 4,356      | 939       | 1,250     | 1,107     | 660        | 335      | 65        |
| Accrued pension benefit     | 3,000      | 3,000     | —         | —         | —          | —        | —         |
| Operating leases            | 46,930     | 3,178     | 5,564     | 5,295     | 5,356      | 5,314    | 22,223    |
|                             | \$ 297,633 | \$ 12,647 | \$ 18,874 | \$ 17,712 | \$ 217,259 | \$ 6,649 | \$ 24,492 |

As at June 29, 2014, outstanding surety bonds guaranteed by the Company amounted to \$108.6 million, representing a decrease compared to \$147.2 million at December 29, 2013. The estimated maturity dates of the surety bonds outstanding at June 29, 2014 range from July 2014 to October 2016.

The Company has not recorded a liability under these guarantees, as management believes that no material events of default exist under any applicable contracts with customers.

Under the Credit Facility, the Company has established a letter of credit sub-facility of \$55.0 million. As at June 29, 2014, letters of credit amounting to \$21.9 million (December 29, 2013: \$22.7 million) remained outstanding under the letter of credit facility as security for the contractual obligations of the Company.

The Company does not have any off-balance sheet arrangement or any material capital asset commitments at June 29, 2014.

### **Stock Option Plan**

The Board adopted a Share Option Plan (the "Option Plan") for NFI on March 21, 2013, under which employees of NFI and certain of its affiliates may receive grants of share options. Directors who are not employed with NFI are not eligible to participate in the Option Plan. A maximum of 3,600,000 Shares are reserved for issuance under the Option Plan. The Options become vested as to one-quarter on the first grant date anniversary and an additional one-quarter on the second, third and fourth anniversary of such date. Each Option must be exercised no later than eight years after the grant date, at which time each Option will expire. No Options may be granted under the Option Plan after March 21, 2023.

| <b>Option series</b>         | <b>Number</b> | <b>Vested</b> | <b>Exercised</b> | <b>Unvested</b> | <b>Expiry date</b> | <b>Exercise price</b> | <b>Fair Value at grant date</b> |
|------------------------------|---------------|---------------|------------------|-----------------|--------------------|-----------------------|---------------------------------|
| Granted on March 26, 2013    | 490,356       | 120,090       | 2,500            | 367,766         | March 26, 2021     | C\$10.20              | C\$1.55                         |
| Granted on December 30, 2013 | 612,050       | —             | —                | 612,050         | December 30, 2021  | C\$10.57              | C\$1.44                         |
|                              | 1,102,406     | 120,090       | 2,500            | 979,816         |                    | C\$10.41              |                                 |

The following reconciles the stock options outstanding:

|                                | <b>June 29, 2014</b> |  | <b>December 29, 2013</b> |  |
|--------------------------------|----------------------|--|--------------------------|--|
|                                | <b>Number</b>        | <b>Weighted average exercise price</b> | <b>Number</b>            | <b>Weighted average exercise price</b> |
| Balance at beginning of period | 490,356              | C\$10.20                               | —                        | —                                      |
| Granted during the period      | 612,050              | C\$10.57                               | 490,356                  | C\$10.20                               |
| Exercised during the period    | (2,500)              | C\$10.20                               | —                        | —                                      |
| Balance at end of period       | 1,099,906            | C\$10.41                               | 490,356                  | C\$10.20                               |

On March 28, 2014, 2,500 stock options were exercised at a price of C\$10.20. The Share price on the exercise date was C\$11.21.

### **Critical accounting estimates and judgments**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### Critical accounting estimates and assumptions

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the actual results. Estimates are reviewed on a regular basis and, as adjustments become necessary, they are reported in the consolidated statements of net earnings and total comprehensive income for the periods in which they become known. The assets and liabilities which require management to make significant estimates and assumptions in determining carrying values include, but are not limited to, inventories, derivative financial instruments, property, plant and equipment, intangible assets, goodwill, provision for warranty costs, accrued benefit liability, accrued bonus liability, deferred compensation obligation and deferred income taxes.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment are addressed below.

#### *Intangible assets and goodwill*

The values associated with intangible assets and goodwill involve significant estimates and assumptions, including those with respect to future cash inflows and outflows, discount rates and asset lives. These significant estimates are subject to the Company's future results. These determinations will affect the amount of amortization expense on intangible assets recognized in future periods. The Company assesses impairment by comparing the recoverable amount of an intangible asset or goodwill with its carrying value. The determination of the recoverable amount involves significant estimation by management. Goodwill is allocated to the Company's three Cash Generating

Units (“CGUs”) for the purpose of impairment testing. The Company performs its annual test for impairment of goodwill and trade names in the fourth quarter of each year.

#### *Employee benefits*

The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension liability. Determination of benefit expense requires assumptions such as the discount rate to measure obligations and return on assets, the projected age of employees upon retirement and the expected rate of future compensation changes. Actual results will differ from results which are estimated based on assumptions.

#### *Income Taxes*

Estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the Company’s ability to utilize the underlying future tax deductions against future taxable income before they expire. The Company’s assessment is based upon existing tax laws and estimates of future taxable income. If the assessment of the Company’s ability to utilize the underlying future tax deductions changes, the Company would be required to recognize more or fewer of the tax deductions as assets, which would decrease or increase the income tax expense in the period in which this is determined.

The Company is subject to taxation in multiple jurisdictions. Significant judgment is required in determining the worldwide provision for taxation. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Company maintains provisions for uncertain tax positions that it believes appropriately reflect its risk with respect to tax matters under active discussion, audit, dispute or appeal with tax authorities, or which are otherwise considered to involve uncertainty. These provisions for uncertain tax positions are made using management’s best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. Management reviews the adequacy of these provisions at each consolidated statements of financial position date. However, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

#### *Provision for Warranty Costs*

The Company offers warranties for its sale of buses. Management estimates the related provision for future warranty claims based on historical warranty claim information as well as recent trends that might suggest that past cost information may differ from future claims. Factors that could impact the estimated claim information include the success of the Company’s productivity and quality initiatives as well as parts and labour costs.

#### Critical judgments in applying accounting policies

The following critical judgments that were made by management have the most significant effect on the amounts recognized in the financial statements.

#### *Revenue recognition*

The Company assessed the criteria for the recognition of revenue related to arrangements that have multiple components as set out in IAS 18. Also, judgment is necessary to determine when components can be recognized separately and the allocation of the related consideration allocated to each component. Also, the Company assessed the criteria for the recognition of revenue in an agency relationship related to the sale of extended warranties that are purchased for the customer from the original equipment manufacturer as set out in IAS 18.

#### *Functional currency*

The Company assessed the criteria for the determination of functional currency as set out in IAS 21. An entity is required to place the greatest weight on the currency that influences the pricing of the transactions that it undertakes rather than focus on the currency in



which the transactions are denominated in. The functional currency of the Company is the United States dollar as it is the currency of the primary economic environment in which the Company operates. In addition, it is the competitive forces of the United States marketplace that determine the sales prices of its goods and services. Predominantly, the costs for labour, material and overhead that address the needs and support the Company's customers are incurred in United States dollars, and hence the pricing of goods and services to the customer is more greatly influenced from operations and the competitive forces in the United States.

#### *Goodwill*

Judgment is required in the selection of CGUs and the allocation of assets and liabilities to these CGUs, which is necessary to assess the impairment of long term assets, goodwill and intangible assets. Management has determined that for purposes of this evaluation the Company has three CGUs: bus manufacturing, aftermarket parts operations (excluding NABI Parts) and NABI Parts.

#### **Standards recently adopted**

##### International Financial Reporting Interpretations Committee ("IFRIC") 21 - Levies

IFRIC 21 provides guidance on when to recognize a liability to pay a levy imposed by the government that is accounted for in accordance with IAS 37 - Provisions, Contingent Liabilities and Contingent Assets. The application of IFRIC 21 had no material impact on the Company's financial position or performance.

#### **Future Changes to Accounting Standards**

The following recently issued accounting pronouncements represent a summary of the pronouncements that are likely to, or may at some future time, have an impact on the Company.

##### IFRS 9 - Financial Instruments:

On July 24, 2014, the International Accounting Standards Board ("IASB") issued IFRS 9 to replace IAS 39, which is effective January 1, 2018 and early adoption is permitted. The standard is being completed in three separate phases. The Company is in the process of reviewing the standard to determine the impact on the Company's financial statements.

##### IFRS 15 - Revenue from Contracts with Customers:

On May 28, 2014, the IASB issued IFRS 15 - Revenue from Contract with Customers, which is effective January 1, 2017 and early adoption is permitted. Under this standard, revenue may be recognized over time in manner that best reflects the Company's performance, or at a point in time, when control of the good or service is transferred to customers. The Company is in the process of reviewing the standard to determine the impact on the Company's financial statements.

#### **Controls and Procedures**

##### **Internal Controls over Financial Reporting**

Management is responsible for establishing and maintaining internal controls over financial reporting ("ICFR"), as defined under rules adopted by the Canadian Securities Administrators. ICFR were designed under the supervision of, and with the participation of, the President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). The Company's ICFR are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Management, under the supervision of the CEO and CFO, evaluated the design of the Company's ICFR as of December 29, 2013 in accordance with the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and concluded that the Company's ICFR are effective.

Management believes there have been no changes in the Company's ICFR during 2014 Q2 that have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

ICFR, no matter how well designed, have inherent limitations. Therefore, ICFR can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements.

#### Disclosure Controls

Management is responsible for establishing and maintaining disclosure controls and procedures in order to provide reasonable assurance that material information relating to the Company is made known to them in a timely manner and that information required to be disclosed is reported within time periods prescribed by applicable securities legislation. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. The Company's CEO and CFO have concluded that disclosure controls and procedures as at December 29, 2013 were effective.

Interim Condensed Consolidated Financial Statements of

**NEW FLYER INDUSTRIES INC.**

June 29, 2014

(Unaudited)

## TABLE OF CONTENTS

|  | <b>Page #</b> |
|--|---------------|
| Interim Condensed Consolidated Statements of Net Earnings and Total Comprehensive Income | 1             |
| Interim Condensed Consolidated Statements of Financial Position                          | 2             |
| Interim Condensed Consolidated Statement of Changes in Equity                            | 3             |
| Interim Condensed Consolidated Statements of Cash Flows                                  | 4             |
| Notes to Interim Condensed Consolidated Financial Statements                             | 5 - 18        |

# NEW FLYER INDUSTRIES INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF NET EARNINGS AND TOTAL COMPREHENSIVE INCOME

For the period ended June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

|  | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013<br>Restated<br>(note 2.5) | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013<br>Restated<br>(note 2.5) |
|--|------------------------------------|--|------------------------------------|--|
| Revenue (note 14)  | \$ 346,484                         | \$ 266,576   | \$ 670,349                         | \$ 511,711   |
| Cost of sales (note 4)   | 309,256                            | 241,645  | 603,107                            | 465,624  |
| <b>Gross profit</b>  | <b>37,228</b>                      | <b>24,931</b>  | <b>67,242</b>                      | <b>46,087</b>  |
| Sales, general and administration costs and other operating expenses     | 21,159                             | 18,356   | 39,987                             | 33,304   |
| Foreign exchange loss (gain)   | 387                                | (219)  | 1,189                              | (507)  |
| <b>Earnings from operations</b>  | <b>15,682</b>                      | <b>6,794</b>   | <b>26,066</b>                      | <b>13,290</b>  |
| Unrealized foreign exchange (gain) loss on non-current monetary items    | (1,000)                            | 1,891  | (620)                              | 2,116  |
| Impairment loss on equipment and intangible assets(note 5)               | 3,919                              | —  | 3,919                              | —  |
| <b>Earnings before interest and income taxes</b>                         | <b>12,763</b>                      | <b>4,903</b>   | <b>22,767</b>                      | <b>11,174</b>  |
| <b>Finance costs</b>   |                                    |  |                                    |  |
| Interest on long-term debt and convertible debentures                    | 2,257                              | 2,142  | 4,514                              | 4,259  |
| Accretion in carrying value of long-term debt and convertible debentures | 549                                | 581  | 1,089                              | 1,149  |
| Other interest and bank charges  | 1,190                              | 817  | 2,013                              | 1,629  |
| Fair value adjustment on interest rate swap                              | 377                                | 864  | 63                                 | 496  |
|  | 4,373                              | 4,404  | 7,679                              | 7,533  |
| <b>Earnings before income tax expense</b>                                | <b>8,390</b>                       | <b>499</b>   | <b>15,088</b>                      | <b>3,641</b>   |
| <b>Income tax expense (recovered) (note 6)</b>                           |                                    |  |                                    |  |
| Current income taxes   | 7,002                              | 3,685  | 10,409                             | 8,173  |
| Deferred taxes (recovered)   | (2,175)                            | (4,870)  | (4,368)                            | (9,729)  |
|  | 4,827                              | (1,185)  | 6,041                              | (1,556)  |
| <b>Net earnings and total comprehensive income</b>                       | <b>\$ 3,563</b>                    | <b>\$ 1,684</b>  | <b>\$ 9,047</b>                    | <b>\$ 5,197</b>  |
| <b>Net earnings per share (basic) (note 10)</b>                          | <b>\$ 0.06</b>                     | <b>\$ 0.03</b>   | <b>\$ 0.16</b>                     | <b>\$ 0.11</b>   |
| <b>Net earnings per share (diluted) (note10)</b>                         | <b>\$ 0.06</b>                     | <b>\$ 0.03</b>   | <b>\$ 0.16</b>                     | <b>\$ 0.11</b>   |

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

# NEW FLYER INDUSTRIES INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 29, 2014

(unaudited, in thousands of U.S. dollars)

|   | June 29, 2014 | December 29, 2013<br>Restated (note 1.1) |
|---|---------------|--|
| <b>Assets</b>                                       |               |  |
| <b>Current</b>                                      |               |  |
| Cash  | \$ 4,314      | \$ 11,896                                |
| Income taxes receivable                             | 3,234         | —  |
| Accounts receivable (note 3,13e)                    | 146,307       | 230,315                                  |
| Inventories (note 4)                                | 246,444       | 183,338                                  |
| Prepaid expenses and deposits                       | 5,697         | 7,658                                    |
|   | 405,996       | 433,207                                  |
| Property, plant and equipment                       | 65,435        | 64,832                                   |
| Unused investment tax credits                       | 8,776         | 13,659                                   |
| Accrued benefit asset                               | 539           | —  |
| Deferred tax assets (note 6)                        | 56,908        | 55,290                                   |
| Goodwill and intangible assets (note 5)             | 556,084       | 569,414                                  |
|   | \$ 1,093,738  | \$ 1,136,402                             |
| <b>Liabilities</b>                                  |               |  |
| <b>Current</b>                                      |               |  |
| Accounts payable and accrued liabilities            | \$ 204,513    | \$ 213,488                               |
| Income taxes payable                                | —             | 504                                      |
| Current portion of deferred revenue                 | 47,662        | 57,614                                   |
| Provision for warranty costs (note 16)              | 25,056        | 26,102                                   |
| Current portion of long-term debt (note 7)          | 30,000        | 35,000                                   |
| Derivative financial instruments                    | 294           | 740                                      |
| Current portion of deferred compensation obligation | 1,477         | 258                                      |
| Current portion of obligations under finance leases | 1,340         | 1,283                                    |
|   | 310,342       | 334,989                                  |
| Accrued benefit liability                           | —             | 228                                      |
| Obligations under finance leases                    | 2,686         | 1,770                                    |
| Deferred compensation obligation                    | 2,075         | 1,663                                    |
| Deferred revenue                                    | 5,550         | 17,382                                   |
| Other long-term liabilities                         | 8,860         | 9,303                                    |
| Deferred tax liabilities (note 6)                   | 112,180       | 114,816                                  |
| Long-term debt (note 7)                             | 140,492       | 140,241                                  |
| Convertible debentures (note 8)                     | 59,126        | 58,322                                   |
| Derivative financial instruments (note 13c)         | 2,571         | 2,508                                    |
|   | 643,882       | 681,222                                  |
| <b>Commitments and contingencies (note 15)</b>      |               |  |
| <b>Shareholders' equity</b>                         |               |  |
| Share capital (note 9)                              | 589,269       | 589,208                                  |
| Stock option reserve                                | 658           | 299                                      |
| Equity component of convertible debentures (note 8) | 3,840         | 3,841                                    |
| Accumulated other comprehensive loss                | (5,001)       | (5,001)                                  |
| Deficit   | (138,910)     | (133,167)                                |
|   | 449,856       | 455,180                                  |
|   | \$ 1,093,738  | \$ 1,136,402                             |

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

Authorized for issue by the board of directors on August 5, 2014.

# NEW FLYER INDUSTRIES INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the period ended June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

|  | Share Capital | Equity<br>Component of<br>Convertible<br>Debentures<br>(note 8) | Stock<br>Option<br>Reserve | Accumulated<br>Other<br>Comprehensive<br>Loss | Deficit      | Total<br>Shareholders'<br>Equity |
|--|---------------|---|----------------------------|---|--------------|----------------------------------|
| <b>Balance, December 30, 2012</b>                  | \$ 476,918    | \$ 3,841  | \$ —                       | \$ (6,490)                                    | \$ (130,281) | \$ 343,988                       |
| Net earnings                                       | —             | —   | —                          | —   | 5,197        | 5,197                            |
| Dividends declared on common shares                | —             | —   | —                          | —   | (14,133)     | (14,133)                         |
| Share based compensation                           | —             | —   | 100                        | —   | —            | 100                              |
| Shares issued                                      | 113,782       | —   | —                          | —   | —            | 113,782                          |
| Share issuance costs (net of tax \$560)            | (1,492)       | —   | —                          | —   | —            | (1,492)                          |
| <b>Balance, June 30, 2013</b>                      | \$ 589,208    | \$ 3,841  | \$ 100                     | \$ (6,490)                                    | \$ (139,217) | \$ 447,442                       |
| Net earnings                                       | —             | —   | —                          | —   | 21,564       | 21,564                           |
| Other comprehensive income                         | —             | —   | —                          | 1,489   | —            | 1,489                            |
| Dividends declared on common shares                | —             | —   | —                          | —   | (15,514)     | (15,514)                         |
| Share based compensation                           | —             | —   | 199                        | —   | —            | 199                              |
| <b>Balance, December 29, 2013</b>                  | \$ 589,208    | \$ 3,841  | \$ 299                     | \$ (5,001)                                    | \$ (133,167) | \$ 455,180                       |
| Net earnings                                       | —             | —   | —                          | —   | 9,047        | 9,047                            |
| Dividends declared on common shares                | —             | —   | —                          | —   | (14,790)     | (14,790)                         |
| Share based compensation                           | —             | —   | 363                        | —   | —            | 363                              |
| Shares issued (note 9)                             | 26            | —   | (4)                        | —   | —            | 22                               |
| Conversion of debentures to common shares (note 8) | 35            | (1)   | —                          | —   | —            | 34                               |
| <b>Balance, June 29, 2014</b>                      | \$ 589,269    | \$ 3,840  | \$ 658                     | \$ (5,001)                                    | \$ (138,910) | \$ 449,856                       |

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

# NEW FLYER INDUSTRIES INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the period ended June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

|   | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Cash generated by (used in)   |                                    |                                    |                                    |                                    |
| <b>Operating activities</b>   |                                    |                                    |                                    |                                    |
| Net earnings for the period   | \$ 3,563                           | \$ 1,684                           | \$ 9,047                           | \$ 5,197                           |
| Income tax (recovered) expense  | 4,827                              | (1,185)                            | 6,041                              | (1,556)                            |
| Depreciation of plant and equipment   | 3,308                              | 2,107                              | 6,206                              | 4,077                              |
| Amortization of intangible assets   | 4,823                              | 4,430                              | 9,643                              | 8,752                              |
| Finance costs recognized in profit or loss  | 4,373                              | 4,404                              | 7,679                              | 7,533                              |
| Unrealized foreign exchange (gain) loss on non-current monetary items   | (1,000)                            | 1,891                              | (620)                              | 2,116                              |
| Foreign exchange gain on cash held in foreign currency  | (351)                              | (125)                              | (379)                              | (746)                              |
| Impairment loss on equipment and intangible assets  | 3,919                              | —                                  | 3,919                              | —                                  |
| Share based compensation  | 158                                | 98                                 | 363                                | 98                                 |
| Realized investment tax credits   | 3,895                              | 799                                | 4,883                              | 2,072                              |
| Defined benefit expense   | 662                                | 647                                | 1,323                              | 1,304                              |
| Defined benefit funding   | —                                  | (2,282)                            | (2,141)                            | (4,322)                            |
| Cash generated by operating activities before non-cash working capital items and interest and income taxes paid | 28,177                             | 12,468                             | 45,964                             | 24,525                             |
| Changes in non-cash working capital items (note 11)   | (18,864)                           | 39,070                             | (10,981)                           | 15,613                             |
| Cash generated by operations before interest and income taxes paid  | 9,313                              | 51,538                             | 34,983                             | 40,138                             |
| Interest paid   | (3,809)                            | (4,739)                            | (7,636)                            | (7,664)                            |
| Income taxes paid   | (4,447)                            | (3,069)                            | (8,839)                            | (13,337)                           |
| Net cash generated by operating activities  | 1,057                              | 43,730                             | 18,508                             | 19,137                             |
| <b>Financing activities</b>   |                                    |                                    |                                    |                                    |
| Repayment of obligations under finance leases   | (319)                              | (506)                              | (677)                              | (1,214)                            |
| Share issuance  | —                                  | 62,378                             | 23                                 | 113,782                            |
| Costs associated with share issuance  | —                                  | (868)                              | —                                  | (2,051)                            |
| Repayment of long-term debt   | —                                  | (10,646)                           | (5,000)                            | (1,933)                            |
| Repayment of other long-term liabilities  | (1,726)                            | —                                  | (598)                              | —                                  |
| Dividends paid  | (7,383)                            | (7,058)                            | (14,780)                           | (13,733)                           |
| Net cash (used) generated by financing activities   | (9,428)                            | 43,300                             | (21,032)                           | 94,851                             |
| <b>Investing activities</b>   |                                    |                                    |                                    |                                    |
| Net cash used in acquisition of NABI business (note 1.1)  | —                                  | (75,023)                           | —                                  | (75,023)                           |
| Acquisition of Orion aftermarket parts business   | —                                  | —                                  | —                                  | (20,608)                           |
| Acquisition of accounts receivables connected with purchase of Orion aftermarket parts business                 | —                                  | —                                  | —                                  | (5,920)                            |
| Acquisition of intangible assets  | (41)                               | —                                  | (113)                              | (5,074)                            |
| Acquisition of property, plant and equipment  | (1,801)                            | (2,291)                            | (5,324)                            | (2,818)                            |
| Net cash used in investing activities   | (1,842)                            | (77,314)                           | (5,437)                            | (109,443)                          |
| Effect of foreign exchange rate on cash   | 351                                | 125                                | 379                                | 746                                |
| (Decrease) increase in cash   | (9,862)                            | 9,841                              | (7,582)                            | 5,291                              |
| Cash — beginning of period  | 14,176                             | 6,632                              | 11,896                             | 11,182                             |
| Cash — end of period  | \$ 4,314                           | \$ 16,473                          | \$ 4,314                           | \$ 16,473                          |

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



# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 1. CORPORATE INFORMATION

New Flyer Industries Inc. (“NFI” or the “Company”) was incorporated on June 16, 2005 under the laws of the Province of Ontario. NFI is the leading manufacturer of heavy-duty transit buses in the United States and Canada. The business also includes aftermarket parts and support including the sale of bus parts.

The Company’s common shares (the “Shares”) are listed on the Toronto Stock Exchange (“TSX”) under the symbol “NFI” and the Company’s 6.25% convertible unsecured subordinated debentures (the “Debentures”) are listed on the TSX under the symbol “NFI.DB.U”.

These unaudited interim condensed consolidated financial statements (the “Statements”) were approved by the Company’s board of directors on August 5, 2014.

#### 1.1 Acquisition of NABI

On June 21, 2013, the Company acquired 100% of the voting equity interest in NABI-Optima Holdings Inc. (“NABI”) from an affiliate of Cerberus Capital Management, L.P. for cash consideration of approximately \$80.0 million, virtually all for the satisfaction of affiliate debt. The purchase price was funded by the proceeds from the C\$64.7 million equity investment by a wholly-owned Canadian subsidiary of Marcopolo S.A. and an additional \$20.0 million that was drawn from the Company’s renewed senior secured credit facility. The acquisition has been accounted for using the acquisition method. The fair values of the identifiable assets and liabilities acquired have been based on management’s best estimates and valuation techniques as at June 21, 2013 (the “Acquisition Date”). The Company adjusted the preliminary purchase price allocation as set out below to account for information that was not readily available at the Acquisition Date. The adjustments recorded resulted in a total increase to goodwill of \$1,081 from the amount previously reported, including a \$550 increase to goodwill during the 26-week period ended June 29, 2014 and as such Goodwill was restated on the interim condensed consolidated statements of financial position at December 29, 2013. The preliminary purchase price allocation of goodwill was finalized during the 13-week period ended June 29, 2014 (“2014 Q2”).

|  | Original  | Adjustments | Revised   |
|--|-----------|-------------|-----------|
| Cash purchase price                            | \$ 80,000 | \$ —        | \$ 80,000 |
| Less: NABI’s cash acquired                     | 7,997     | (3,020)     | 4,977     |
| Net cash used in acquisition                   | 72,003    | 3,020       | 75,023    |
| <b>Net assets acquired</b>                     |           |             |           |
| Accounts receivable                            | 54,493    | (6,897)     | 47,596    |
| Inventories                                    | 55,575    | 6,851       | 62,426    |
| Prepaid expenses and deposits                  | 788       | —           | 788       |
| Property, plant and equipment                  | 15,558    | —           | 15,558    |
| Accounts payable and accrued liabilities       | (62,734)  | 1,985       | (60,749)  |
| Deferred revenue                               | (10,794)  | —           | (10,794)  |
| Provision for warranties                       | (15,410)  | —           | (15,410)  |
| Other long-term liabilities                    | (10,102)  | —           | (10,102)  |
| <b>Net tangible assets acquired</b>            | 27,374    | 1,939       | 29,313    |
| Trade names                                    | 7,100     | —           | 7,100     |
| Patent and licenses                            | 3,200     | —           | 3,200     |
| Customer relationships                         | 26,000    | —           | 26,000    |
| <b>Identifiable intangible assets acquired</b> | 36,300    | —           | 36,300    |
| <b>Goodwill acquired</b>                       | \$ 8,329  | \$ 1,081    | \$ 9,410  |

The Company operates the NABI bus and NABI parts operations of NABI under the entities NABI Bus, LLC (“NABI Bus”) and NABI Parts, LLC (“NABI Parts”), respectively. Both companies are part of the New Flyer group of companies. The goodwill acquired is largely attributable to the synergies and economies of scale expected from the combined businesses of NFI and NABI. This goodwill is expected to be deductible for tax purposes.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these Statements are the same as those applied by the Company in its consolidated financial statements as at and for the 52-week period ended December 29, 2013. These Statements should be read in conjunction with the Company's consolidated financial statements as at and for the 52-week period ended December 29, 2013.

#### 2.1 Statement of compliance

The Statements are unaudited and have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all the information required for full annual financial statements.

#### 2.2 Basis of preparation

The Statements were prepared on a going concern basis in accordance with International Financial Reporting Standards ("IFRS") which requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, revenue and expenses. Actual results may differ from these estimates.

In preparing these Statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied by the Company in its consolidated financial statements as at and for the 52-week period ended December 29, 2013.

#### 2.3 Principles of consolidation

The Statements include the accounts of all of the Company's subsidiaries: New Flyer Holdings, Inc., Transit Holdings, Inc., New Flyer of America Inc., New Flyer Industries Canada ULC, 1176846 Alberta ULC, TCB Enterprises, LLC, NABI Bus, NABI Parts, Transit Acquisition, LLC, Transit Parts Holdings, Inc. and Transit Finco, Inc.

The Company and Alexander Dennis Limited have a contractual joint arrangement for the commercialization of MiDi<sup>®</sup>, a mid-sized bus, in the medium-duty transit markets in Canada and the United States. The Company is responsible for sales, marketing, manufacturing and aftermarket support with Alexander Dennis Limited performing engineering, test and prototype development activities. The Company recognizes in relation to its interest in a joint operation: its assets, including its share of any assets held jointly; its liabilities, including its share of any liabilities incurred jointly; its revenue from the sale of its share of the output arising from the joint operation; its share of the revenue from the sale of the output by the joint operation; and its expenses, including its share of any expenses incurred jointly.

#### 2.4 Standards recently adopted

##### International Financial Reporting Interpretations Committee ("IFRIC") 21 - Levies

IFRIC 21 provides guidance on when to recognize a liability to pay a levy imposed by the government that is accounted for in accordance with IAS 37 - Provisions, Contingent Liabilities and Contingent Assets. The application of IFRIC 21 had no material impact on the Company's financial position or performance.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### 2.5 Comparative information

In preparing the 2013 comparative information, the Company has adjusted amounts reported previously in the consolidated financial statements as a result of the retroactive correction of an error relating to revenue recognition of extended warranties and original equipment manufacturer's extended warranties. The following are the impacts on the Company's Statements for the 13-weeks and 26-weeks ended June 30, 2013.

|  | 13-Weeks<br>ended June<br>30, 2013 | 26-Weeks<br>ended June<br>30, 2013 |
|--|------------------------------------|------------------------------------|
| Net earnings and total comprehensive income impact |                                    |                                    |
| Decrease in revenue                                | \$ 2,093                           | \$ 4,336                           |
| Decrease in cost of sales                          | 2,093                              | 4,336                              |
| Net earnings and total comprehensive income impact | \$ —                               | \$ —                               |

#### 2.6 Standards issued but not yet adopted

##### IFRS 9 - Financial Instruments:

On July 24, 2014, the International Accounting Standards Board ("IASB") issued IFRS 9 to replace IAS 39, which is effective January 1, 2018 and early adoption is permitted. The standard is being completed in three separate phases. The Company is in the process of reviewing the standard to determine the impact on the Company's financial statements.

##### IFRS 15 - Revenue from Contracts with Customers:

On May 28, 2014, the IASB issued IFRS 15 - Revenue from Contract with Customers, which is effective January 1, 2017 and early adoption is permitted. Under this standard, revenue may be recognized over time in manner that best reflects the Company's performance, or at a point in time, when control of the good or service is transferred to customers. The Company is in the process of reviewing the standard to determine the impact on the Company's financial statements.

#### 2.7 Fiscal periods

The Company's 2014 fiscal period is divided in quarters as follows:

|             | Period from<br>December 30, 2013<br>to December 28, 2014<br>("Fiscal 2014") |            | Period from<br>December 31, 2012<br>to December 29, 2013<br>("Fiscal 2013") |            |
|-------------|---|------------|---|------------|
|             | Period End Date   | # of Weeks | Period End Date   | # of Weeks |
| Quarter 1   | March 30, 2014  | 13         | March 31, 2013  | 13         |
| Quarter 2   | June 29, 2014   | 13         | June 30, 2013   | 13         |
| Quarter 3   | September 28, 2014  | 13         | September 29, 2013  | 13         |
| Quarter 4   | December 28, 2014   | 13         | December 29, 2013   | 13         |
| Fiscal year | December 28, 2014   | 52         | December 29, 2013   | 52         |

### 3. ACCOUNTS RECEIVABLE

|       | June 29, 2014 | December 29, 2013 |
|-------|---------------|-------------------|
| Trade | \$ 134,441    | \$ 221,314        |
| Other | 11,866        | 9,001             |
|       | \$ 146,307    | \$ 230,315        |

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 4. INVENTORIES

|                 | June 29, 2014     | December 29, 2013 |
|-----------------|-------------------|-------------------|
| Raw materials   | \$ 129,238        | \$ 108,166        |
| Work in process | 91,342            | 64,670            |
| Finished goods  | 25,864            | 10,502            |
|                 | <u>\$ 246,444</u> | <u>\$ 183,338</u> |

|   | 13-Weeks<br>Ended<br>June 29,<br>2014 | 13-Weeks<br>Ended<br>June 30,<br>2013 | 26-Weeks<br>Ended<br>June 29,<br>2014 | 26-Weeks<br>Ended<br>June 30,<br>2013 |
|---|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Cost of inventories recognized as expense and included in cost of sales | \$ 297,654                            | \$ 224,351                            | \$ 581,206                            | \$ 431,095                            |
| Write-down of inventory to net realizable value in cost of sales        | 604                                   | 260                                   | 1,127                                 | 490                                   |
| Reversals of a previous write-down in inventory                         | 48                                    | —                                     | 252                                   | —                                     |

### 5. GOODWILL AND INTANGIBLE ASSETS

|   | Goodwill<br>Restated<br>(note 1.1) | Trade names       | Patents and<br>Licenses | Customer<br>relationships | Total             |
|---|------------------------------------|-------------------|-------------------------|---------------------------|-------------------|
| Cost                                    | \$ 212,655                         | \$ 161,300        | \$ 110,125              | \$ 190,821                | \$ 674,901        |
| Accumulated amortization                | —                                  | —                 | 55,411                  | 50,076                    | 105,487           |
| <b>December 29, 2013 net book value</b> | <b>212,655</b>                     | <b>161,300</b>    | <b>54,714</b>           | <b>140,745</b>            | <b>569,414</b>    |
| Additions                               | —                                  | —                 | 113                     | —                         | 113               |
| Amortization charge                     | —                                  | —                 | (4,937)                 | (4,706)                   | (9,643)           |
| Impairment loss                         | —                                  | (3,800)           | —                       | —                         | (3,800)           |
| <b>June 29, 2014 net book value</b>     | <b>\$ 212,655</b>                  | <b>\$ 157,500</b> | <b>\$ 49,890</b>        | <b>\$ 136,039</b>         | <b>\$ 556,084</b> |

#### Impairment losses

On June 24, 2014 the Company announced its plan to rationalize to a common Xcelsior® platform for all heavy-duty and bus rapid transit (“BRT”) buses. As a result, production of NABI LFW and NABI BRT models will be phased out, with the Anniston, Alabama facility expected to transition to Xcelsior in the second half of 2015. The Company expects to deliver NABI Bus orders as previously committed and to provide support for NABI Bus customers of the LFW and BRT products for as long as those buses are in service.

Management carried out a review of the recoverable amount of related assets. The review led to the recognition of an impairment loss of \$3,800 relating to the NABI Bus trade name. Management also identified \$119 of NABI Bus related equipment that no longer meets the definition of an asset and has been fully written-off. The total impairment loss of \$3,919 has been included in net earnings and total comprehensive income. These assets are used in the Company’s bus operations cash generating unit (“CGU”).

Management has identified NABI Bus related equipment and patents with an approximate net book value of \$9,300 that will be used to manufacture the remaining NABI Bus LFW bus models through to the second half of 2015. The estimated useful lives of the identified equipment and intangible assets will be adjusted to align with the final production dates and depreciation and amortization will be accelerated accordingly.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 5. GOODWILL AND INTANGIBLE ASSETS (Continued)

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use estimated cash flow projections based on financial plans approved by the Board covering a three-year period and discount rates based on weighted average cost of capital of like businesses that range between 9% and 13% per annum for the Bus Operations CGU and between 7% and 11% per annum for the Aftermarket Operations CGUs. Cash flows beyond this period are extrapolated using a steady estimated growth rate based on the long-term average annual growth rate of 3% for each industry in which the CGUs operate.

Management has determined planned gross margins based on a projected production schedule, past performance and expectations of market development. The discount rates used reflect specific risk relating to the relevant operating segments.

Impairment may result if the following occur:

- the cash flow projections are lower by 14% annually,
- the average annual growth rate is decreased up to 3.0%, or
- the discount rate is higher by at least 2.5%.

Based upon historical operating results, management's forecasts and previous business plans, the NABI Parts trade name had been assigned an indefinite life. However, based on management's decision to phase out the NABI Bus models, it was determined that the useful life assessment should be changed from indefinite to finite life. This change is accounted for as a change in an accounting estimate in accordance with IAS 8. The NABI Parts trade name has a carrying value of \$3,300 which will be amortized over the estimated useful life of 12 years.

### 6. DEFERRED TAXES AND INCOME TAX EXPENSE

|   | June 29, 2014      | December 29, 2013  |
|---|--------------------|--------------------|
| Deferred tax assets:  |                    |                    |
| Deferred tax asset to be recovered after more than 12 months    | \$ 45,492          | \$ 43,422          |
| Deferred tax asset to be recovered within 12 months             | 14,834             | 15,476             |
|   | <u>60,326</u>      | <u>58,898</u>      |
| Deferred tax liabilities:                                       |                    |                    |
| Deferred tax liability to be reversed after more than 12 months | (109,312)          | (112,531)          |
| Deferred tax liability to be reversed within 12 months          | (6,286)            | (5,893)            |
|   | <u>(115,598)</u>   | <u>(118,424)</u>   |
|   | <u>\$ (55,272)</u> | <u>\$ (59,526)</u> |

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. The offset amounts by tax jurisdiction presented on the statements of financial position are as follows:

|   | June 29, 2014      | December 29, 2013  |
|---|--------------------|--------------------|
| As presented on statements of financial position: |                    |                    |
| Deferred tax assets                               | \$ 56,908          | \$ 55,290          |
| Deferred tax liabilities                          | (112,180)          | (114,816)          |
|   | <u>\$ (55,272)</u> | <u>\$ (59,526)</u> |

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 6. DEFERRED TAXES AND INCOME TAX EXPENSE (Continued)

The gross movement on the deferred income tax account is as follows:

|   | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Beginning of period   | \$ (58,332)                        | \$ (68,339)                        | \$ (59,526)                        | \$ (72,912)                        |
| Exchange differences  | 983                                | (915)                              | 79                                 | (1,351)                            |
| Tax recorded through net earnings   | 2,175                              | 4,870                              | 4,368                              | 9,729                              |
| Benefit of loss carry forward and share issuance costs<br>recognized against income taxes payable | (98)                               | (138)                              | (193)                              | (314)                              |
| Tax recorded through equity   | —                                  | 234                                | —                                  | 560                                |
| End of period   | \$ (55,272)                        | \$ (64,288)                        | \$ (55,272)                        | \$ (64,288)                        |

The movement in deferred income tax assets and liabilities during the periods, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

|   | Property, Plant<br>and Equipment | Pension  | Goodwill and<br>Intangibles | Other      | Total        |
|---|----------------------------------|----------|-----------------------------|------------|--------------|
| <b>Deferred tax liabilities</b>             |                                  |          |                             |            |              |
| December 29, 2013                           | \$ (214)                         | \$ —     | \$ (116,540)                | \$ (1,670) | \$ (118,424) |
| Tax reversed (charged) through net earnings | 81                               | (203)    | 2,983                       | (35)       | 2,826        |
| June 29, 2014                               | \$ (133)                         | \$ (203) | \$ (113,557)                | \$ (1,705) | \$ (115,598) |

|   | Provisions | Property,<br>Plant and<br>Equipment | Pension | Deferred<br>Financing<br>Costs and<br>Interest | Other     | Total     |
|---|------------|-------------------------------------|---------|--|-----------|-----------|
| <b>Deferred tax assets</b>  |            |                                     |         |  |           |           |
| December 29, 2013   | \$ 10,748  | \$ 10,688                           | \$ 86   | \$ 19,705                                      | \$ 17,671 | \$ 58,898 |
| Tax recovered (charged) through net earnings  | 2,967      | 194                                 | (86)    | (2,756)  | 1,223     | 1,542     |
| Benefit of loss carry forward and share issuance<br>costs recognized against income taxes payable | —          | —                                   | —       | (193)  | —         | (193)     |
| Exchange differences  | 15         | 15                                  | —       | 27   | 22        | 79        |
| June 29, 2014   | \$ 13,730  | \$ 10,897                           | \$ —    | \$ 16,783                                      | \$ 18,916 | \$ 60,326 |

The reconciliation of income tax computed at the U.S. statutory rate, to income tax expense is as follows:

|   | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Earnings before income tax expense                                  | \$ 8,390                           | \$ 499                             | \$ 15,088                          | \$ 3,641                           |
| Tax calculated using a 35% U.S. tax rate                            | 2,937                              | 174                                | 5,281                              | 1,274                              |
| Tax effect of:  |                                    |                                    |                                    |                                    |
| Withholding and other taxes   | 124                                | 126                                | 463                                | 247                                |
| Non-deductible expenses   | (238)                              | 305                                | (559)                              | 53                                 |
| Revision of tax estimates   | 13                                 | 378                                | 13                                 | 698                                |
| Rate differential on income taxed at other than U.S. statutory rate | (247)                              | (231)                              | (668)                              | (581)                              |
| Foreign exchange impact   | 1,679                              | (1,520)                            | 1,085                              | (2,601)                            |
| State taxes   | 517                                | (279)                              | 372                                | (477)                              |
| Other   | 42                                 | (138)                              | 54                                 | (169)                              |
| <b>Income tax expense (recovered) for the period</b>                | <b>\$ 4,827</b>                    | <b>\$ (1,185)</b>                  | <b>\$ 6,041</b>                    | <b>\$ (1,556)</b>                  |

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 7. LONG-TERM DEBT

|   | Final<br>Maturity | Face<br>Value | Unamortized<br>Transaction<br>Costs | Net Book<br>Value<br>June 29,<br>2014 | Net Book<br>Value<br>December 29,<br>2013 |
|---|-------------------|---------------|-------------------------------------|---------------------------------------|---|
| Term Credit Facility                    | April 2017        | \$ 142,000    | \$ 1,508                            | \$ 140,492                            | \$ 140,241                                |
| Revolving Credit Facility ("Revolver")  | April 2017        | 30,000        | —                                   | 30,000                                | 35,000                                    |
|   |                   | 172,000       | 1,508                               | 170,492                               | 175,241                                   |
| Less: current portion of long-term debt |                   | 30,000        | —                                   | 30,000                                | 35,000                                    |
|   |                   | \$ 142,000    | \$ 1,508                            | \$ 140,492                            | \$ 140,241                                |

The Company's fourth amended and restated credit agreement has a total borrowing limit of \$257.0 million. The borrowing limit of the Revolver is \$115.0 million to support working capital fluctuations. The Revolver includes a \$55.0 million letter of credit sub-facility, of which \$21.9 million of outstanding letters of credit were drawn at June 29, 2014. The borrowing limit of the term facility (the "Term Credit Facility") is \$142.0 million. The Credit Facility also includes an accordion feature of \$75 million for future investment or acquisition opportunities.

Loans under the Term Credit Facility bear interest at a rate equal to LIBOR or a U.S. base rate for loans denominated in U.S. dollars and a Canadian prime rate or bankers' acceptance rate for loans denominated in Canadian dollars, plus an applicable margin to those rates. The obligations in respect of the Credit Facility are secured by: (a) a perfected lien on, and pledge of, (i) all inter-company notes owing to NFI, and (ii) all of the capital stock of, and inter-company notes owing to all of NFI's existing and direct and indirect subsidiaries, and (b) a perfected lien on, and security interest in, all of the existing and future tangible and intangible properties and assets of NFI and its direct and indirect subsidiaries, with certain exceptions.

### 8. CONVERTIBLE DEBENTURES

On June 5, 2012, the Company completed a public offering of \$65 million aggregate principal amount of Debentures, bearing interest at a rate of 6.25% per annum, payable semi-annually on the last day of June and December commencing on December 31, 2012. The Debentures will mature on June 30, 2017 (the "Maturity Date"). The Debentures are convertible at the holder's option into Shares at a conversion price of \$10.00 per Share (the "Conversion Option").

On and after June 30, 2015 and prior to maturity, the Debentures may be redeemed in whole or in part from time to time at the Company's option, at a price equal to their principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of the Shares on the TSX for the 20 consecutive trading days preceding the date on which the notice of redemption is given is not less than 125% of the conversion price. The Debentures are not redeemable prior to June 30, 2015.

On the Maturity Date, the Company shall repay the holders in cash the principal of the Debentures outstanding and all accrued and unpaid interest thereon, up to but excluding the Maturity Date. However, the Company may, at its option, subject to receiving all applicable regulatory approvals and giving the required notice, elect to satisfy its obligation to repay on the Maturity Date the principal amount, in whole or in part, by issuing and delivering to holders that number of fully paid and non-assessable freely tradeable Shares calculated by dividing the principal amount of Debentures by 95% of the current market price of the Shares on the fifth trading day preceding the Maturity Date.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 8. CONVERTIBLE DEBENTURES (Continued)

On the date of issuance, the gross proceeds in the amount of \$65,000 were allocated firstly to the liability component of the Debentures based on the fair value of a similar instrument without a conversion option and the residual value being allocated to the Conversion Option. The fair value of the Debentures was estimated by calculating the discounted cash flows of the Debentures using prevailing market rates for similar non-convertible debt instruments. The fair value of the Debentures is classified as a liability, while the residual value of the Debentures, net of taxes, is classified as a separate component of shareholders' equity. The liability component will accrete to its final redemption amount of \$65,000 less all conversions, at Maturity Date at an effective interest rate over the five-year term of the Debentures.

During 2014 Q2, a principal amount of \$37 of Debentures was converted, resulting in a total principal amount of \$64,963 Debentures outstanding at June 29, 2014.

|   | Debt<br>liability<br>component | Equity<br>component of<br>Debt | Net Book<br>Value<br>June 29, 2014 | Net Book Value<br>December 29,<br>2013 |
|---|--------------------------------|--------------------------------|------------------------------------|--|
| Proceeds from issue of Debentures             | \$ 59,412                      | \$ 5,588                       | \$ 65,000                          | \$ 65,000                              |
| Debt issuance costs                           | (3,463)                        | (326)                          | (3,789)                            | (3,789)                                |
| Net proceeds                                  | 55,949                         | 5,262                          | 61,211                             | 61,211                                 |
| Deferred taxes                                | —                              | (1,421)                        | (1,421)                            | (1,421)                                |
| Accretion in carrying value of debt liability | 3,211                          | —                              | 3,211                              | 2,373                                  |
| Conversion of Debentures to Shares            | (34)                           | (1)                            | (35)                               | —                                      |
| Net book value                                | \$ 59,126                      | \$ 3,840                       | \$ 62,966                          | \$ 62,163                              |

### 9. SHARE CAPITAL

Authorized

Unlimited Shares

Issued

55,473,104 Shares (December 29, 2013: 55,466,904)

June 29, 2014  
December 29,  
2013

\$ 589,269 \$ 589,208

The following is a summary of changes to the issued and outstanding capital stock during the periods:

| Shares   | Number<br>(000s) | Net Book Value |
|--|------------------|----------------|
| Balance - December 29, 2013                        | 55,467           | \$ 589,208     |
| Stock options exercised                            | 2                | 26             |
| Conversion of Debentures to Shares on May 28, 2014 | 4                | 35             |
| Balance - June 29, 2014                            | 55,473           | \$ 589,269     |

The dividends declared during 2014 Q2 and the 13-weeks ended June 30, 2013 ("2013 Q2") were \$7,473 (\$0.1347 per Share) and \$7,263 (\$0.1453 per Share) respectively. Dividends of \$2,537 (\$0.0457 per Share) were proposed or declared after June 29, 2014 but prior to the Statements being authorized for issue. The Statements do not reflect this dividend payable.



# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 10. EARNINGS PER SHARE

|  | 13-Weeks<br>Ended<br>June 29,<br>2014 | 13-Weeks<br>Ended<br>June 30,<br>2013 | 26-Weeks<br>Ended<br>June 29,<br>2014 | 26-Weeks<br>Ended<br>June 30,<br>2013 |
|--|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Net earnings attributable to equity holders                      | \$ 3,563                              | \$ 1,684                              | \$ 9,047                              | \$ 5,197                              |
| Weighted average number of Shares in issue                       | 55,470,705                            | 49,981,776                            | 55,468,846                            | 48,371,210                            |
| Net incremental shares from assumed conversion of stock options  | 145,274                               | —                                     | 101,398                               | —                                     |
| Weighted average number of Shares for diluted earnings per Share | 55,615,979                            | 49,981,776                            | 55,570,244                            | 48,371,210                            |
| <b>Net earnings per Share (basic)</b>                            | 0.0642                                | 0.0300                                | 0.1631                                | 0.1100                                |
| <b>Net earnings per Share (diluted)</b>                          | \$ 0.0641                             | \$ 0.0300                             | \$ 0.1628                             | \$ 0.1100                             |

Basic earnings per Share is calculated by dividing the net earnings attributable to equity holders of the Company by the weighted average number of Shares outstanding during the period excluding Shares purchased by the Company and held as treasury shares. During the period the Company did not hold any Shares as treasury shares.

Diluted earnings per Share is calculated using the same method as basic earnings per Share except that the average number of Shares outstanding includes the potential dilutive effect of outstanding stock options granted by the Company as determined by the treasury stock method. Dilution could occur through the exercise of stock options, the exercise of the Conversion Option or the Debentures being repaid with Shares at Maturity Date at 95% of market price. Currently, the 6,496,300 Shares issuable pursuant to the conversion of the Debentures are considered anti-dilutive, therefore both the convertible debenture Shares and the related interest are disregarded in calculating diluted earnings per Share.

### 11. SUPPLEMENTAL CASH FLOW INFORMATION

#### Changes in non-cash working capital items

|  | 13-Weeks<br>Ended<br>June 29, 2014 | 13-Weeks<br>Ended<br>June 30, 2013 | 26-Weeks<br>Ended<br>June 29, 2014 | 26-Weeks<br>Ended<br>June 30, 2013 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Cash inflow (outflow)                    |                                    |                                    |                                    |                                    |
| Accounts receivable                      | \$ 54,738                          | \$ 16,288                          | \$ 84,008                          | \$ (9,393)                         |
| Income taxes recoverable                 | (1,622)                            | (286)                              | (3,234)                            | (968)                              |
| Inventories                              | (38,778)                           | 13,023                             | (63,106)                           | 24,448                             |
| Prepaid expenses and deposits            | 926                                | (2,971)                            | 1,961                              | (3,833)                            |
| Accounts payable and accrued liabilities | (21,514)                           | 17,194                             | (8,975)                            | 16,209                             |
| Income taxes payable                     | —                                  | —                                  | (504)                              | (6,756)                            |
| Deferred revenue                         | (11,476)                           | (594)                              | (21,784)                           | (7,201)                            |
| Provision for warranty costs             | (73)                               | 461                                | (1,046)                            | 87                                 |
| Other                                    | (1,065)                            | (4,045)                            | 1,699                              | 3,020                              |
|  | \$ (18,864)                        | \$ 39,070                          | \$ (10,981)                        | \$ 15,613                          |

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 12. SHARE-BASED COMPENSATION

The Board adopted a Share Option Plan (the "Option Plan") for NFI on March 21, 2013, under which employees of NFI and certain of its affiliates may receive grants of share options. Directors who are not employed with NFI are not eligible to participate in the Option Plan. A maximum of 3,600,000 Shares are reserved for issuance under the Option Plan. The Options become vested as to one-quarter on the first grant date anniversary and an additional one-quarter on the second, third and fourth anniversary of such date.

| Option series                | Number    | Vested  | Exercised | Unvested | Expiry date       | Exercise price | Fair Value at grant date |
|------------------------------|-----------|---------|-----------|----------|-------------------|----------------|--------------------------|
| Granted on March 26, 2013    | 490,356   | 120,090 | 2,500     | 367,766  | March 26, 2021    | C\$10.20       | C\$1.55                  |
| Granted on December 30, 2013 | 612,050   | —       | —         | 612,050  | December 30, 2021 | C\$10.57       | C\$1.44                  |
|                              | 1,102,406 | 120,090 | 2,500     | 979,816  |                   | C\$10.41       |                          |

The following reconciles the stock options outstanding:

|                                | <u>26-Weeks ended June 29, 2014</u> |                                 | <u>26-Weeks ended June 30, 2013</u> |                                 |
|--------------------------------|-------------------------------------|---------------------------------|-------------------------------------|---------------------------------|
|                                | Number                              | Weighted average exercise price | Number                              | Weighted average exercise price |
| Balance at beginning of period | 490,356                             | C\$10.20                        | —                                   | —                               |
| Granted during the period      | 612,050                             | C\$10.57                        | 490,356                             | C\$10.20                        |
| Exercised during the period    | (2,500)                             | C\$10.20                        | —                                   | —                               |
| Balance at end of period       | 1,099,906                           | C\$10.41                        | 490,356                             | C\$10.20                        |

On March 28, 2014, 2,500 stock options were exercised at a price of C\$10.20. The Share price on the exercise date was C\$11.21.

### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### (a) Financial Instruments

The Company has made the following classifications:

|   |                                   |
|---|-----------------------------------|
| Cash                                      | Loans and receivables             |
| Accounts receivable                       | Loans and receivables             |
| Deposits                                  | Loans and receivables             |
| Accounts payables and accrued liabilities | Other Liabilities                 |
| Convertible debentures                    | Other Liabilities                 |
| Long-term debt                            | Other Liabilities                 |
| Derivative financial instruments          | Fair value through profit or loss |

#### (b) Fair value measurement of financial instruments

The Company categorizes its fair value measurements of financial instruments recorded at fair value according to a three-level hierarchy. The hierarchy prioritizes the inputs used by the Company's valuation techniques. A level is assigned to each fair value measurement based on the lowest level input significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are defined as follows:

Level 1 - fair value measurements that reflect unadjusted, quoted prices in active markets for identical assets and liabilities that the Company has the ability to access at the measurement date.

Level 2 - fair value measurements using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in inactive markets, inputs that are observable that are not prices (such as interest rates and credit risks) and inputs that are derived from or corroborated by observable market data.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

Level 3 - fair value measurements using significant non-market observable inputs. These include valuations for assets and liabilities that are derived using data, some or all of which is not market observable data, including assumptions about risk.

The following table presents the carrying amounts and fair values of financial liabilities, including their levels in the fair value hierarchy. The table distinguishes between those financial instruments recorded at fair value and those recorded at amortized cost. The table also excludes fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

|   | June 29, 2014    |                 |            |
|---|------------------|-----------------|------------|
|   | Fair value level | Carrying amount | Fair value |
| <b>Financial liabilities recorded at fair value</b>     |                  |                 |            |
| Derivative financial instrument liabilities             |                  |                 |            |
| Foreign exchange forward contracts                      | Level 2          | \$ 294          | \$ 294     |
| Interest rate swap                                      | Level 2          | 2,571           | 2,571      |
| <b>Financial liabilities recorded at amortized cost</b> |                  |                 |            |
| Debentures (including equity conversion option)         | Level 2          | \$ 62,966       | \$ 76,936  |

#### (c) Risk Management

The Company uses derivative financial instruments including interest rate swaps, foreign exchange options and forward foreign exchange contracts. These instruments are financial contracts whose value depends on interest rates and foreign currency prices.

The use of derivatives allows the transfer, modification and reduction of current and expected risks, including interest rate, foreign exchange and other market risks. The Company uses derivative financial instruments to manage interest rate and foreign exchange risks in accordance with its risk management policies. Certain derivative instruments, while providing effective economic hedges, are not designated as hedges for accounting purposes. Changes in the fair value of any derivatives that are not designated as hedges for accounting purposes are recognized within "finance costs" or "unrealized foreign exchange loss on non-current monetary items" in the interim condensed consolidated statements of net earnings and total comprehensive income consistent with the underlying nature and purpose of the derivative instruments.

In connection with the Credit Facility, the Company has an interest rate swap designed to hedge floating rate exposure for the term of the Credit Facility on \$142,000 of drawn term loan. The interest rate swap fixes the interest rate at 1.46% plus the applicable interest margin until April 2017. The fair value of the interest rate swap liability at June 29, 2014 was \$2,571 (December 29, 2013: \$2,508) and the change in fair value has been recorded as finance costs for the reported period. The related liability has been recorded on the consolidated statements of financial position as a derivative financial instruments liability.

#### (d) Liquidity Management

The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity to meet liabilities when due. At June 29, 2014, the Company had a cash balance of \$4,314 (December 29, 2013: \$11,896) and the \$115,000 Revolver. As at June 29, 2014, there was \$30,000 of direct borrowings (December 29, 2013: \$35,000) and \$21,899 of outstanding letters of credit (December 29, 2013: \$22,681) under the Revolver.

The Company's principal sources of funds are cash generated from its operating activities, share issuances and borrowing capacity remaining under the Credit Facility. Management believes that these funds will provide NFI with sufficient liquidity and capital resources to meet its current and future financial obligations as they come due, as well as to provide funds for its financing requirements, capital expenditures and other needs for the foreseeable future.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

#### (e) Credit risk

The carrying amount of accounts receivable is reduced through the use of an allowance account and the amount of the loss is recognized in the interim condensed consolidated statements of net earnings and total comprehensive income within "sales, general and administration costs and other operating expenses". When a receivable balance is considered uncollectible, it is written off against the allowance for doubtful accounts. Subsequent recoveries of amounts previously written off are credited against "sales, general and administration costs and other operating expenses" in the interim condensed consolidated statements of net earnings and total comprehensive income.

The following table details the aging of the Company's receivables and related allowance for doubtful accounts as follows:

|  | June 29,<br>2014 | December 29,<br>2013 |
|--|------------------|----------------------|
| Current, including holdbacks             | \$ 129,613       | \$ 213,101           |
| <u>Past due amounts but not impaired</u> |                  |                      |
| 1 - 60 days                              | 14,670           | 16,370               |
| Greater than 60 days                     | 2,529            | 1,270                |
| Less: Allowance for doubtful accounts    | (505)            | (426)                |
| Total accounts receivables, net          | \$ 146,307       | \$ 230,315           |

As at June 29, 2014, there was no amount that would otherwise be past due or impaired whose terms have been renegotiated.

There are certain financial covenants under the Credit Facility that must be maintained. These financial covenants include an interest coverage ratio and total leverage ratio. As at June 29, 2014, the Company was in compliance with the financial covenants in the Credit Facility. The results of the financial covenants tests as of such date are as follows:

|   | June 29, 2014 | December 29, 2013 |
|---|---------------|-------------------|
| Total Leverage Ratio (must be less than 3.25)       | 1.69          | 1.67              |
| Interest Coverage Ratio (must be greater than 3.00) | 8.81          | 9.21              |

Compliance with financial covenants is reported quarterly to the board of directors. Other than the requirements imposed by borrowing agreements, the Company is not subject to any externally imposed capital requirements. Capital management objectives are reviewed on an annual basis. The capital management objectives are unchanged from the last reporting period.

### 14. SEGMENT INFORMATION

The Company has two reportable segments: Bus Operations and Aftermarket Operations, which are the Company's strategic business units. The strategic business units offer different products and services, and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the Company's President and CEO reviews internal management reports on a monthly basis.

The Bus Operations segment derives its revenue from the manufacture of transit buses for public transportation. The Aftermarket Operations segment derives its revenue from the provision of service parts and support related to transit buses and sale of used buses. These operating segments are consistent with the management of the business, which is based on the products and services offered.

There is no inter-segment revenue. Unallocated items in the consolidated earnings before income taxes primarily include unrealized foreign exchange gains or losses and finance costs. Corporate overhead costs are allocated fully to the Bus Operations segment.

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 14. SEGMENT INFORMATION (Continued)

The Bus Operations segment has recorded vendor rebates of \$1,686 (2013 Q2: \$1,535), which have been recognized into earnings during 2014 Q2, but for which the full requirements for entitlement to these rebates have not yet been met.

The unallocated total assets of the Company primarily include cash, intangible assets, derivative financial instruments and deferred income tax assets. Corporate assets that are shared by both operating segments are allocated fully to the Bus Operations segment.

Segment information about profits and assets is as follows:

|   | 13-Weeks<br>Ended<br>June 29, 2014 |                           |             |            |
|---|------------------------------------|---------------------------|-------------|------------|
|   | Bus Operations                     | Aftermarket<br>Operations | Unallocated | Total      |
| Revenue from external customers           | \$ 265,831                         | \$ 80,653                 | \$ —        | \$ 346,484 |
| Operating costs and expenses              | 265,702                            | 69,019                    | —           | 334,721    |
| Earnings (loss) before income tax expense | 129                                | 11,634                    | (3,373)     | 8,390      |
| Total assets                              | 523,671                            | 208,003                   | 362,064     | 1,093,738  |
| Addition of capital expenditures          | 1,790                              | 11                        | —           | 1,801      |
| Addition of goodwill and intangibles      | 13                                 | 28                        | —           | 41         |
| Goodwill                                  | 149,950                            | 62,705                    | —           | 212,655    |

|   | 13-Weeks<br>Ended<br>June 30, 2013 |                           |             |            |
|---|------------------------------------|---------------------------|-------------|------------|
|   | Bus Operations                     | Aftermarket<br>Operations | Unallocated | Total      |
| Revenue from external customers           | \$ 215,230                         | \$ 51,346                 | \$ —        | \$ 266,576 |
| Operating costs and expenses              | 206,608                            | 47,986                    | —           | 254,594    |
| Earnings (loss) before income tax expense | 8,622                              | 3,360                     | (11,483)    | 499        |
| Total assets                              | 456,436                            | 178,710                   | 450,978     | 1,086,124  |
| Addition of capital expenditures          | 1,451                              | 446                       | —           | 1,897      |
| Addition of goodwill and intangibles      | 8,443                              | 36,736                    | —           | 45,179     |
| Goodwill                                  | 149,950                            | 62,705                    | —           | 212,655    |

|   | 26-Weeks<br>Ended<br>June 29, 2014 |                           |             |            |
|---|------------------------------------|---------------------------|-------------|------------|
|   | Bus Operations                     | Aftermarket<br>Operations | Unallocated | Total      |
| Revenue from external customers           | \$ 516,720                         | \$ 153,629                | \$ —        | \$ 670,349 |
| Operating costs and expenses              | 517,106                            | 131,096                   | —           | 648,202    |
| Earnings (loss) before income tax expense | (386)                              | 22,533                    | (7,059)     | 15,088     |
| Total assets                              | 523,671                            | 208,003                   | 362,064     | 1,093,738  |
| Addition of capital expenditures          | 5,225                              | 99                        | —           | 5,324      |
| Addition of goodwill and intangibles      | 36                                 | 77                        | —           | 113        |
| Goodwill                                  | 149,950                            | 62,705                    | —           | 212,655    |

# NEW FLYER INDUSTRIES INC.

## NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 29, 2014

(unaudited, in thousands of U.S. dollars except per share figures)

### 14. SEGMENT INFORMATION (Continued)

|   |                | 26-Weeks<br>Ended<br>June 30, 2013 |             |            |
|---|----------------|------------------------------------|-------------|------------|
|   | Bus Operations | Aftermarket<br>Operations          | Unallocated | Total      |
| Revenue from external customers           | \$ 423,025     | \$ 88,686                          | \$ —        | \$ 511,711 |
| Operating costs and expenses              | 406,063        | 80,036                             | —           | 486,099    |
| Earnings (loss) before income tax expense | 16,962         | 8,650                              | (21,971)    | 3,641      |
| <br>                                      |                |                                    |             |            |
| Total assets                              | 456,436        | 178,710                            | 450,978     | 1,086,124  |
| Addition of capital expenditures          | 1,973          | 845                                | —           | 2,818      |
| Addition of goodwill and intangibles      | 8,470          | 49,889                             | —           | 58,359     |
| Goodwill                                  | 149,950        | 62,705                             | —           | 212,655    |

### 15. COMMITMENTS AND CONTINGENCIES

- (a) Through the normal course of operations, the Company has indemnified the surety companies providing surety bonds required under various contracts with customers. In the event that the Company fails to perform under a contract and the surety companies incur a cost on a surety bond, the Company is obligated to repay the costs incurred in relation to the claim up to the value of the bond. The Company's guarantee under each bond issued by the surety companies expires on completion of obligations under the customer contract to which the bond relates. The estimated maturity dates of the surety bonds outstanding at June 29, 2014 range from July 2014 to October 2016.

At June 29, 2014, outstanding surety bonds guaranteed by the Company totaled \$108,616 (December 29, 2013: \$147,202). The Company has not recorded any liability under these guarantees, as management believes that no material events of default exist under any contracts with customers.

- (b) The Company has a letter of credit sub-facility of \$55,000 as part of the \$115,000 Revolver. As at June 29, 2014, letters of credit totaling \$21,899 (December 29, 2013: \$22,681) remain outstanding under the letter of credit facility.

As at June 29, 2014, management believes that the Company is in compliance in all material respects with all applicable contractual obligations and the Company has not provided for any costs associated with these letters of credit.

### 16. PROVISION FOR WARRANTY COSTS

The Company generally provides its customers with a one-year base warranty on the entire bus and a 12-year corrosion warranty on the bus structure. The Company also provides certain extended warranties, including those covering brake systems, lower level components, fleet defect provisions and engine-related components, covering a warranty period of approximately one to five years, depending on the contract. The movement in the provision for warranty costs during the period is as follows:

|  | Total     |
|--|-----------|
| December 29, 2013  | \$ 26,102 |
| Additions  | 9,303     |
| Amounts used   | (9,430)   |
| Unwinding of discount and effect of changes in the discount rate | (185)     |
| Exchange differences   | (734)     |
| June 29, 2014  | \$ 25,056 |