August 8, 2012

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE 13-WEEKS AND 26-WEEKS ENDED JULY 1, 2012

Information in this Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations of NFI (as defined below) 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 ("2012 Q2") and the 26-week period ("2012 YTD") ended July 1, 2012. 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 and New Flyer Industries Canada ULC ("NFI ULC") available on SEDAR at 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 and reporting currencies 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

New Flyer Industries Inc. ("NFI"), an Ontario corporation, is the issuer of common shares ("Shares") and NFI ULC, an Alberta unlimited liability corporation, is the issuer of C$55.30 principal amount of 14.0% Subordinated Notes ("Subordinated Notes"), that, together with one Share form an income deposit security of the Issuer ("IDS"). As of July 1, 2012, 44,379,070 Shares were outstanding, 436,955 of which were represented by IDSs. Each IDS represents one Share and C$55.30 principal amount of Subordinated Notes. Unless otherwise stated or the context otherwise requires, references to the "Issuer" refer, collectively, to NFI and NFI ULC. References in this MD&A to "New Flyer" or the "Company" are to New Flyer Industries Inc. and its consolidated subsidiaries. References in this MD&A to "management" are to management of the Company and the Issuer.

The Shares are traded on the Toronto Stock Exchange ("TSX") under the symbol NFI, the IDSs are traded on the TSX under the symbol NFI.UN and NFI's 6.25% convertible unsecured subordinated debentures ("Debentures") are traded on the TSX under the symbol NFI.DB.U. Additional information about the Issuer and the Company, including the Issuer's annual information form is available on SEDAR at 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 ("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 the Issuer's and the Company's future growth, results of operations, performance and business prospects and opportunities. The words "believes", "anticipates", "plans", "expects", "intends", "projects", "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, competition in the heavy-duty transit bus industry, 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, material losses and product liability claims, changes in Canadian or United States tax legislation, the Company's success depends on a limited number of key executives who the Company may not be able to adequately replace in the event that they leave the Company, 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, the Company's ability to generate cash from the planned reduction in excess work in process, 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 and Subordinated Note indenture could impact the ability of the Company to fund distributions 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, the ability of the Company to successfully execute strategic plans and maintain profitability and risks related to acquisitions, joint ventures, and other strategic relationships with third parties. The Issuer cautions that this list of factors is not exhaustive. These factors and other risks and uncertainties are discussed in the Issuer's press releases and materials filed with the Canadian securities regulatory authorities and are available on SEDAR at 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 the Issuer 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 EBITDA, ADJUSTED EBITDA AND FREE CASH FLOW

References to "EBITDA" are to earnings before interest expense, income taxes, depreciation and amortization; losses or gains on disposal of property, plant and equipment; unrealized foreign exchange losses or gains on non-current monetary items and forward foreign exchange contracts and fair value adjustment to embedded derivatives. 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 business acquisition related costs, loss on debt repurchase, loss on exercise of redemption right, warranty expense assumed as a result of the ISE Corporation ("ISE") bankruptcy, past service pension costs, realized and unrealized investment tax credits, and costs associated with assessing strategic and corporate initiatives.

Management believes EBITDA, Adjusted EBITDA and Free Cash Flow (as defined below) are useful measures in evaluating the performance of the Company and/or the Issuer. "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, business acquisition related costs, costs associated with assessing strategic and corporate initiatives, past service pension costs, proceeds on sale of redundant assets and decreased for defined benefit expense, cash capital expenditures and principal payments on capital leases. However, EBITDA, Adjusted EBITDA and Free Cash Flow are not recognized earnings measures and do not have standardized meanings prescribed by IFRS. Readers of this MD&A are cautioned that 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 the Company's and/or the Issuer'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 heading "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".

The Issuer's method of calculating 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 or distributions paid from Free Cash Flow are not assured, and the actual amount of dividends or distributions received by holders of Shares and IDSs will depend on, among other things, the Company's financial performance, debt covenants and obligations, working capital requirements, future capital requirements and the deductibility for U.S. federal income tax purposes of interest payments on the Subordinated Notes, all of which are susceptible to a number of risks, as described in the Issuer's public filings available on SEDAR at www.sedar.com.

### Business Overview

New Flyer is the leading manufacturer of heavy-duty transit buses in the United States and Canada and a leading provider of aftermarket parts and support. The Company operates three manufacturing facilities in Winnipeg, MB, St. Cloud, MN and Crookston,

MN (all ISO 9001, ISO 14001 and OHSAS 18001 certified), as well as a bus parts fabrication facility in Elkhart, Indiana. The Company also has four parts distribution centers in Winnipeg, MB, Brampton, ON, Erlanger, KY and Fresno, CA and a service center in Arnprior, ON. With a skilled workforce of over 2,000 employees, New Flyer is the technology leader in the heavy-duty transit bus market, offering the broadest and most advanced product line in the industry. New Flyer's mission statement is: to deliver the best bus value and support for life.

**Industry Overview**

*Funding for Heavy-Duty Transit market*

The most recent U.S. government transportation bill (SAFETEA-LU) expired June 30, 2012, after receiving nine consecutive extensions from its original expiry date of September 30, 2009.

On June 29, 2012, U.S. Congress approved a two-year transportation bill named "Moving Ahead for Progress in the 21st Century Act" (MAP-21/H.R 4348) whereby federal public transportation funding will continue equal to current funding levels plus inflation for two fiscal years. Public transportation funds are set at $10.45 billion for fiscal 2012, $10.57 billion in fiscal 2013 and $10.69 billion in fiscal 2014. The approved bill was signed by President Barack Obama on July 6, 2012. The bill provides for a limited increase in federal transit programs, as well as extensions of authorizations for fiscal 2012 based on current law and is in place until September 2014. Management is assessing the impact of this legislation on future transit industry capital spending.

While U.S. state and local funding continues to be a challenge, on a positive note, U.S. state tax collections increased in the second quarter of 2012 for the 9th consecutive quarter, with a reported 4.1% increase over the prior year.

A recent national survey released by the Canadian Urban Transit Association ("CUTA") indicates that Canada's transit infrastructure requires C$53.0 billion over the next five years. Based on the growing demand in the last decade, the Canadian federal government has given high priority to improving transit infrastructure and services and investment has grown substantially. Thanks to strong commitments by all levels of Canadian government, three-quarters of the total Canadian transit infrastructure needs can be drawn from existing funding streams. The remaining C$13.5 billion will have to come from new or additional sources. Recently, the minister of Transport, Infrastructure and Communities, the Honourable Denis Lebel, launched a formal process that will lead to the development and adoption of Canada's next long-term infrastructure plan. Currently, the vast majority of Canadian federal funding for transit in the last decade came from the Building Canada Plan that will expire in 2014.

*Recent Ridership Trends*

Public bus transportation ridership surged in the first quarter of 2012, as Americans took nearly 1.4 billion trips, an increase of 4.5% over the first quarter of last year, according to a report released June 6, 2012 by the American Public Transportation Association (APTA). This was the fifth consecutive quarter of U.S. public bus transit ridership increase, as 58.6 million more bus trips were taken in the first quarter of 2012 compared to the first quarter of 2011. Management believes the increased ridership is a result of rising employment, higher gasoline prices and improved services. For example, public bus transportation systems are delivering better, reliable service and the use of real time technology, which many systems use, makes it easy for riders to know when the next bus will arrive.

Public transit ridership across Canada set another all-time high last year with record growth. According to CUTA, Canadians took 1.99 billion trips on 2011, a ridership increase of 4.56% from the previous year. This surge represents the largest single year-over-year ridership increase in the last decade, with the addition of well over 86.0 million new trips. As well, CUTA reported that ridership for all modes of public transportation increased by 3.3% for first quarter of 2012 compared to first quarter of 2011. The timing of the Canadian data typically lags behind APTA's current ridership statistics by approximately half a year.

*Demand for Heavy-Duty Transit Buses*

In 2009 the Company created and tracks a new potential "pipeline" or "bid universe" of anticipated heavy-duty transit bus order activity in North America. The pipeline consists of: bids received with proposal in process, bids submitted and awaiting award and solicitations expected to be released by U.S. and Canadian transit agencies within a five-year horizon. At the end of 2012 Q2, there were

approximately 15,184 EUs in New Flyer's new potential pipeline or bid universe for heavy-duty transit buses, up slightly from the approximately 15,100 EUs reported at the end of 13-week period ended April 1, 2012 (“2012 Q1”).

*Competitive Environment*

Price, engineering to customer specification, styling, product quality, on-time delivery, established track record, strong customer relationships and bidders’ financial strength are some of the key factors in winning bus manufacturing contracts. With customers experiencing significant budget pressure in the past few years, price has taken on a more meaningful weighting. The competitive landscape of the industry in the United States and Canada is limited to now only four major competitors including: New Flyer, Gillig Corporation, North American Bus Industries which is owned by Cerberus Capital and Nova Bus which is owned by Volvo. Daimler Buses North America, Inc ("DBNA") announced on April 25, 2012 that it has decided to immediately exit the heavy-duty transit bus business in North America and to wind down production of Orion buses in the U.S. and Canada.

As a result of DBNA’s decision to exit the heavy-duty transit bus sector, DBNA assigned to New Flyer its contract with New York City Transit Authority and the MTA Bus Company (together, "NYCT") to build 74 heavy-duty 40-foot CNG buses. The contract includes an additional 30 option buses that will not be ordered at this time. The 74 EUs base order for the assigned U.S. Federal Transit Administration funded contract will commence production in August 2012, all of which are expected to be delivered to NYCT by the end of the year. The buses will be virtually identical to New Flyer's existing contract with NYCT for 385 buses currently in production. This contract assignment further extends the long standing partnership between New Flyer and NYCT, allowing New Flyer to deliver to NYCT a proven and reliable product supported by New Flyer warranty, service and lifetime customer care.

Management believes that the pricing remains aggressive among the remaining competitors, however the number of active competitions has increased as anticipated.

*Aftermarket Parts*

The Company provides parts and support for buses manufactured by both New Flyer and its competitors. Management believes that New Flyer provides the most comprehensive aftermarket support of all manufacturers in the industry today. Competitors in the aftermarket parts business include competing bus manufacturers, bus parts distributors and parts divisions of related industries (e.g., heavy-duty trucks).

In the aftermarket parts segment, gross orders received during 2012 Q2 for New Flyer core aftermarket parts sales were down by 6.5% compared to 2011 Q2. 2012 YTD gross orders, however, were up slightly at $56.9M compared to $56.2M for the same period in 2011. Continued tight funding and increased competition has created pricing pressure and lower margins. However, on a positive note, a number of major transit authorities have procurement competitions outstanding for supply chain solutions to optimize their warehouses, storerooms and manage their supply chain. These types of vendor managed inventory contracts take a considerable amount of time to go through the competitive process and to launch but management continues to see significant potential.

Delivery of six of the New Flyer fleet of used articulated buses previously owned by OC Transpo occurred during 2012 Q2.

**2012 Second Quarter in Review**

Order activity during 2012 Q2 was 498 EUs, with a total value of $222.5 million, an increase from $77.9 million for 2012 Q1. The 2012 Q2 order activity comprises new firm and new option orders of 90 EUs and exercised options of 408 EUs. Included in this order activity are a mix of new and repeat customers, with approximately 56% of the EUs for clean-propulsion vehicles (i.e., hybrid or CNG), reflecting diversification of New Flyer's portfolio of products and customers.

The Company has pending orders for an additional 613 EUs and options for 60 EUs pending from a number of customers where approval had been granted by the customer's board, council, or commission, as appropriate, but purchase documentation had not yet been received by the Company and therefore not yet included in the backlog at July 1, 2012. Included in the 613 EUs orders are the 74 EUs from the assigned NYCT contract described above and 233 EUs from two other contracts signed after July 16, 2012.

The most significant order in the period was announced in May 2012, where New Flyer was awarded an order for 100 sixty-foot articulated buses (200 EUs) for the Chicago Transit Authority (“CTA”) in support of their fleet renewal and customer enhancement

strategies. The last purchase of heavy-duty transit buses by the CTA was in 2009 - and was also with New Flyer. The CTA currently operates 1,780 transit buses in their fleet, 1,258 of which are New Flyer buses. The order was placed using options from another U.S. transit agency, and is valued at approximately $80.1 million. The 67 clean-diesel buses and 33 hybrid diesel-electric buses are ideal for high-capacity, high-frequency routes and assist with reducing road congestion. Each bus will be equipped with New Flyer Connect™, New Flyer's onboard remote vehicle management system. New Flyer Connect™ enables the CTA to achieve the best performance and safety out of their buses by providing the right information to the right people at the right time. Real time problem reporting of operational and vehicle health data provides transit authorities with the ability to monitor and improve fuel economy, schedule preventative maintenance and ensure that the vehicle operates safely.

Deliveries in 2012 Q2 increased to 441 EUs compared to 431 EUs in the 13-week period ended July 3, 2011 ("2011 Q2"). Management expects that New Flyer's existing backlog position combined with the order intake over the last 12 months is expected to enable the Company to maintain the current production line entry rate of approximately 36 EUs per week, consistent with the Company's annual operating plan.

The total backlog at the end of 2012 Q2 was 6,213 EUs with a total value of $2.65 billion, a decrease of 6.2% compared to the EU backlog at the end of 2012 Q1. The firm portion of the total backlog at the end of 2012 Q2 was 1,267 EUs, a slight increase over the 1,210 EUs at the end of 2012 Q1. This decrease in total backlog is consistent with management's expectations taking into account the current market conditions and upcoming procurements.

On June 1, 2012 the Company unveiled a prototype of its all-electric 40-foot Xcelsior heavy-duty transit bus. The prototype is based on New Flyer's successful 40-foot Xcelsior heavy-duty transit bus, North America's most advanced bus platform available today. The bus is equipped with an electric drive and is modified to carry advanced lithium ion batteries from Mitsubishi Heavy Industries that are charged from the city's electrical grid instead of by a conventional diesel engine.

A few weeks later New Flyer announced that CTA had placed an order for two 40' all-electric battery heavy-duty transit buses. This order is New Flyer's first commercial contract for the all-electric battery powered bus.

In 2011 New Flyer formally announced its intention to change its corporate structure from an IDS structure to a traditional common share structure to provide greater financial flexibility to pursue strategic growth and diversification opportunities as well as other benefits. The non-cash rights offering completed in August 2011 was the initial step in this transaction. In June 2012 the final steps required to complete the process began and will culminate upon the redemption of the Subordinated Notes in August 2012.

In order to fund the August 2012 redemption, the Company completed a public offering on June 5, 2012, on a "bought deal" basis, of $65.0 million 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 holder of the Debenture will have the option to convert each $1,000 principal amount of their Debenture into 100 Shares ("Conversion Option"). The Debentures will not be redeemable prior to June 30, 2015. 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 Toronto Stock Exchange 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.

On June 25, 2012, NFI ULC formally issued notice that it will redeem all of its 14.0% Subordinated Notes, including the 14.0% subordinated notes outstanding that were issued under the same terms and conditions as the Subordinated Notes held by third parties in accordance with the terms of the trust indenture governing the Subordinated Notes (the "Indenture"). These Subordinated Notes will be redeemed on August 20, 2012 at a total price of C$58.4812 per C$55.30 principal amount of Subordinated Notes, representing an early redemption price of C$58.065 per C$55.30 principal amount of Subordinated Notes (or 105% of principal), plus all accrued and unpaid interest to and including the redemption date. Notice of the redemption of the Subordinated Notes has been delivered to CDS Clearing and Depository Services Inc. in accordance with the terms of the Indenture.

A loss on exercise of redemption right of $5.5 million was recognized during 2012 Q2 as a result of recognizing the 5% early redemption premium, the remaining unamortized transaction costs and the change in fair value of the embedded derivative call option included in the Subordinated Notes.

The redemption of the 14.0% Subordinated Notes will be financed with the net proceeds of NFI's recently completed public offering of Debentures. As the Subordinated Notes are denominated and redeemable in Canadian dollars, the Company converted the U.S. dollar proceeds from the Debentures offering into Canadian dollars on June 5, 2012. The pre-tax net interest savings as a result of redeeming 14.0% Subordinated Notes by issuing 6.25% Debentures is approximately $4.0 million per year. Upon completion of the redemption of the Subordinated Notes, NFI ULC will apply to cease to be a reporting issuer under the securities laws of each province and territory of Canada. New Flyer will also apply to de-list the IDSs from the TSX and, following such de-listing, the Shares that form part of an IDS will commence trading separately and continue to be listed (together with the current Shares of NFI) on the TSX under the trading symbol "NFI".

**Fiscal 2012 Second Quarter Financial Results**

The Company generated consolidated revenue of $227.0 million for 2012 Q2, an increase of 0.5% compared to consolidated revenue for 2011 Q2 of $225.9 million, and consolidated revenue for 2012 YTD of $454.6 million, an increase of 3.3% from consolidated revenue for the 26-week period ended July 3, 2011 ("2011 YTD") of $440.2 million.

Revenue from bus manufacturing operations for 2012 Q2 was $197.4 million, an increase of 1.4% from $194.7 million in 2011 Q2, and revenue of $393.6 million for 2012 YTD increased 3.0% from $382.2 million for 2011 YTD. The increase in 2012 Q2 revenue primarily resulted from a 2.3% increase in total bus deliveries of 441 EUs in 2012 Q2 compared to 2011 Q2 deliveries of 431 EUs, offset by a 0.9% decrease in average selling price per EU in 2012 Q2 compared to 2011 Q2. The average selling price per EU in 2012 Q2 was $447.5 thousand which decreased slightly compared to $451.8 thousand in 2011 Q2. Bus deliveries in 2012 YTD totaled 883 EUs, a decrease of 1.8% compared to 899 EUs in 2011 YTD. The 2012 YTD decrease in deliveries is partly due to lower production rates in 2012 YTD compared to 2011 YTD to meet management's plan for a sustainable production rate for the 2012 fiscal year, while the average selling price per EU in 2012 YTD was $445.8 thousand, an increase from $425.1 thousand in 2011 YTD.

Revenue from aftermarket operations (excluding used bus sales) in 2012 Q2 was $29.3 million as compared to $29.2 million in 2011 Q2. Used bus sales in 2012 Q2 were $0.3 million compared to $1.9 million in 2011 Q2. Revenue from aftermarket operations (excluding used bus sales) for 2012 YTD of $60.5 million, an increase of 7.8% compared to $56.1 million in 2011 YTD. Used bus sales in 2012 YTD were $0.6 million compared to $1.9 million in 2011 YTD.

Consolidated Adjusted EBITDA for 2012 Q2 totaled $16.4 million compared to $20.0 million in 2011 Q2, which represents a decrease of 18.3%. In comparing the respective periods, this decrease in consolidated Adjusted EBITDA is primarily due to contract runs with lower average contract margins in the bus manufacturing operations sales mix during 2012 Q2 as compared to 2011 Q2, related to lower average selling prices offset somewhat by increased efficiency due to the Company's Operational Excellence ("OpEx") program.

2012 Q2 bus manufacturing operations Adjusted EBITDA of $11.3 million decreased 11.0% compared with 2011 Q2 bus manufacturing operations Adjusted EBITDA of $12.7 million. This decrease is primarily the result of lower contract margins related to lower average selling price, offset by increased OpEx efficiencies. 2012 Q2 aftermarket operations Adjusted EBITDA of $5.1 million (17.1% of revenue) decreased 31.0% compared to $7.4 million (23.6% of revenue) in 2011 Q2, primarily due to lower profit margins driven by industry price pressure, the operating costs of the newer parts distribution centers required to achieve future revenue growth and the $0.9 million of decreased Adjusted EBITDA which resulted from the sale of used buses 2011 Q2.

2012 YTD consolidated Adjusted EBITDA of $33.1 million (7.3% of revenue) decreased by 21.4% compared to 2011 YTD consolidated Adjusted EBITDA of $42.0 million (9.6% of revenue). Bus manufacturing operations Adjusted EBITDA of $22.2 million for 2012 YTD decreased 23.5% compared to $29.0 million for 2011 YTD bus manufacturing operations Adjusted EBITDA. This decrease in Adjusted EBITDA is primarily a result of sales mix with lower average margins, decreased investment tax credits realized in 2012 YTD of $0.5 million compared to $3.1 million in 2011 YTD and a $0.5 million charge as a result of the one-time signing bonus provided to union employees under the Company's Winnipeg collective bargaining agreement ("CBA"); however the benefit will be realized over the remaining two quarters of Fiscal 2012 due to the negotiated wage freeze. Aftermarket operations Adjusted EBITDA for 2012 YTD of $10.8 million (17.7% of revenue) represents a decrease of 16.6% over 2011 YTD aftermarket operations Adjusted EBITDA of $13.0 million (22.4% of revenue).

Management expects that Adjusted EBITDA during the second half of 2012 will be stronger than 2012 YTD, based on the positive impact derived from the contract sales mix, strategic insourcing and overhead cost reductions.

The Company reported a net earnings of $3.6 million in 2012 Q2 representing an improvement compared to a net loss of $7.3 million in 2011 Q2, primarily as a result of $9.2 million decrease of finance costs and $2.8 million decrease in income taxes. The decrease in income taxes when comparing the two periods was primarily the result of an $11.1 million decrease in deferred income taxes offset by an $8.3 million increase in current income taxes. The current income tax expense increased primarily as a result of increased Canadian taxable income without the previous benefit of loss carryforwards, whereas the deferred income tax recovered increased in the current period due to the exercise of the redemption right regarding the Subordinated Notes. Similar to 2012 Q2, 2012 YTD net earnings of $6.3 million increased compared to 2011 YTD net loss of $13.7 million, due to significantly reduced finance costs and decrease in income tax expense.

Up to this date, the board of directors of NFI (the "Board") has declared annual dividend payments of C$0.86 per Share. As previously disclosed, the Board has maintained this dividend rate until NFI ULC redeems the remaining Subordinated Notes on August 20, 2012. On August 8, 2012, the Board set a new annual dividend rate equal to C$0.585 per Share, effective for all dividends declared after the redemption of the Subordinated Notes. See “Dividend Policy”.

The Company generated Free Cash Flow of C$5.8 million during 2012 Q2 while declaring dividends of C$9.5 million as compared to C$7.9 million of Free Cash Flow generated in 2011 Q2 and declared dividends of C$4.9 million. During 2012 YTD, New Flyer generated Free Cash Flow of C$16.4 million while declaring dividends of C$19.1 million as compared to C$12.1 million of Free Cash Flow generated in 2011 YTD and declared dividends of C$9.8 million. Although, the current Free Cash Flow generated is not sufficient, provisions have been made to sustain dividends until August 2012 when the Board reduces the annualized dividend payment to C$0.585 per Share. See “Dividend Policy”. Management expects improved cash flow in the second half of 2012 as compared to 2012 YTD as a result of increased Adjusted EBITDA, lower interest costs, lower working capital balances and decrease in dividends paid. The reduced dividend is expected to produce an annual improvement in cash flows of C$12.2 million, based on the current number of shares outstanding.

During 2012 Q2, the Company increased its cash by $59.7 million, primarily due to $61.2 million of net cash generated by the issuance of the Debentures which will be used to redeem the Subordinated Notes on August 20, 2012 and increase in delayed draw term loan, offset by $2.1 million invested in new equipment. The Company continues to invest in machinery and equipment that improves efficiency and provides enhanced insourcing capabilities. Funding for these growth capital expenditures have been through a mix of cash and utilization of the Company’s delayed draw term loan.

The July 1, 2012 liquidity position of $61.1 million is comprised of available cash of $5.5 million (as $61.7 million of the $67.2 million of cash on hand has been earmarked for redemption of the Subordinated Notes) and $55.6 million of available secured revolving credit facility. As at July 1, 2012, there were $21.0 million of direct borrowings and $13.4 million of outstanding letters of credits related to the $90.0 million of secured revolving credit. 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 and future 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.

**SELECTED 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.

**QUARTERLY AND ANNUAL FINANCIAL INFORMATION**
(unaudited, US dollars in thousands, except for deliveries in equivalent units and per share figures)

| Fiscal Period | Quarter | Revenue | Earnings from Operations | Net earnings (loss) | EBITDA[1] | Adjusted EBITDA[1] | Earnings (loss) per share[3] |
|---|---|---|---|---|---|---|---|
| 2012 | Q2 | $ 226,980 | $ 10,686 | $ 3,604 | $ 11,055 | $ 16,366 | $ 0.08 |
| | Q1 | 227,644 | 8,010 | 2,727 | 14,032 | 16,686 | 0.06 |
| | **Total** | **$ 454,624** | **$ 18,696** | **$ 6,331** | **$ 25,087** | **$ 33,052** | **$ 0.14** |
| 2011 | Q4 | $ 256,918 | $ 30,063 | $ 17,803 | $ 35,214 | $ 15,855 | $ 0.40 |
| | Q3 | 229,308 | 15,764 | 15,074 | 18,228 | 22,206 | 0.62 |
| | Q2 | 225,853 | 12,811 | (7,319) | 18,765 | 20,037 | (1.48) |
| | Q1 | 214,344 | 14,991 | (6,361) | 20,943 | 21,989 | (1.29) |
| | **Total** | **$ 926,423** | **$ 73,629** | **$ 19,197** | **$ 93,150** | **$ 80,087** | **$ 0.98** |
| 2010 | Q4 | $ 204,791 | $ 2,894 | $ (13,623) | $ 9,138 | $ 17,822 | $ (2.75) |
| | Q3 | 255,447 | 19,052 | (3,215) | 25,158 | 25,163 | (0.65) |
| | Q2 | 280,540 | 27,284 | 33,167 | 33,183 | 33,310 | 6.97 |
| | Q1 | 242,980 | 15,310 | (13,928) | 20,987 | 20,987 | (2.94) |
| | **Total** | **$ 983,758** | **$ 64,540** | **$ 2,401** | **$ 88,466** | **$ 97,282** | **$ 0.50** |

| | | | | | | Inventory comprised of: | |
|---|---|---|---|---|---|---|---|
| Fiscal Period | Quarter | Inventory, Beginning (equivalent units)[2] | New Line Entry (equivalent units)[2] | Deliveries (equivalent units)[2] | Inventory, Ending (equivalent units)[2] | Work in process (equivalent units)[2] | Finished goods (equivalent units)[2] & [4] |
| 2012 | Q2 | 175 | 453 | 441 | 187 | 167 | 20 |
| | Q1 | 189 | 428 | 442 | 175 | 163 | 12 |
| | **Total** | **189** | **881** | **883** | **187** | **167** | **20** |
| 2011 | Q4 | 238 | 421 | 470 | 189 | 185 | 4 |
| | Q3 | 236 | 444 | 442 | 238 | 233 | 5 |
| | Q2 | 218 | 449 | 431 | 236 | 224 | 12 |
| | Q1 | 209 | 477 | 468 | 218 | 200 | 18 |
| | **Total** | **209** | **1,791** | **1,811** | **189** | **185** | **4** |
| 2010 | Q4 | 241 | 467 | 499 | 209 | 206 | 3 |
| | Q3 | 262 | 505 | 526 | 241 | 236 | 5 |
| | Q2 | 299 | 508 | 545 | 262 | 235 | 27 |
| | Q1 | 245 | 507 | 453 | 299 | 287 | 12 |
| | **Total** | **245** | **1,987** | **2,023** | **209** | **206** | **3** |

**COMPARISON OF SECOND QUARTER AND TRAILING TWELVE MONTHS RESULTS**

(Unaudited, US dollars in thousands, except for deliveries in equivalent units)

| | 13-Weeks Ended July 1, 2012 | 13-Weeks Ended July 3, 2011 | 26-Weeks Ended July 1, 2012 | 26-Weeks Ended July 3, 2011 | 52-weeks Ended July 1, 2012 | 52-weeks Ended July 3, 2011 |
|---|---|---|---|---|---|---|
| **Statement of Earnings Data** | | | | | | |
| Revenue | | | | | | |
| Canada | $ 47,553 | $ 35,420 | $ 80,413 | $ 120,879 | $ 133,389 | $ 315,866 |
| U.S. | 149,816 | 159,303 | 313,189 | 261,302 | 688,447 | 475,218 |
| Bus manufacturing operations | 197,369 | 194,723 | 393,602 | 382,181 | 821,836 | 791,084 |
| Canada | 9,795 | 9,726 | 19,490 | 18,855 | 37,926 | 36,496 |
| U.S. | 19,816 | 21,404 | 41,532 | 39,161 | 81,086 | 72,855 |
| Aftermarket operations | 29,611 | 31,130 | 61,022 | 58,016 | 119,012 | 109,351 |
| Total revenue | $ 226,980 | $ 225,853 | $ 454,624 | $ 440,197 | $ 940,848 | $ 900,435 |
| Earnings from operations | $ 10,686 | $ 12,811 | $ 18,696 | $ 27,802 | $ 64,523 | $ 58,432 |
| Earnings before interest and income taxes | 5,848 | 6,931 | 11,504 | 16,370 | 63,785 | 21,125 |
| Net (loss) earnings | 3,604 | (7,319) | 6,331 | (13,680) | 39,208 | (30,518) |
| EBITDA[1] | 11,055 | 18,765 | 25,087 | 39,708 | 78,529 | 74,004 |
| Adjusted EBITDA[1] | | | | | | |
| Bus manufacturing operations including realized foreign exchange losses/gains | 11,291 | 12,682 | 22,232 | 29,048 | 49,796 | 60,704 |
| Aftermarket operations | 5,075 | 7,355 | 10,820 | 12,978 | 21,317 | 24,307 |
| Total Adjusted EBITDA[1] | $ 16,366 | $ 20,037 | $ 33,052 | $ 42,026 | $ 71,113 | $ 85,011 |
| **Other Data (unaudited)** | | | | | | |
| Canada | 113 | 80 | 191 | 333 | 313 | 905 |
| U.S. | 328 | 351 | 692 | 566 | 1,482 | 1,019 |
| Total deliveries (equivalent units)[2] | 441 | 431 | 883 | 899 | 1,795 | 1,924 |
| Total capital expenditures | $ 2,352 | $ 1,155 | $ 6,012 | $ 2,570 | $ 12,133 | $ 6,659 |
| New options awarded | $ — | $ 143,985 | $ — | $ 159,540 | $ 50,207 | $ 445,352 |
| New firm orders awarded | 50,319 | 28,193 | 62,336 | 76,021 | 72,965 | 251,663 |
| Exercised options | 172,241 | 299,677 | 238,110 | 329,849 | 433,989 | 491,171 |
| Total firm orders | $ 222,560 | $ 327,870 | $ 300,446 | $ 405,870 | $ 506,954 | $ 742,834 |

| (Unaudited, US dollars in thousands) | July 1, 2012 | | January 1, 2012 | | January 2, 2011 | |
|---|---|---|---|---|---|---|
| **Selected Balance Sheet Data** | | | | | | |
| Total assets | $ 924,794 | | $ 870,462 | | $ 848,933 | |
| Long-term financial liabilities | 312,989 | | 300,234 | | 549,865 | |
| **Other Data** | | Equivalent Units[2] | | Equivalent Units[2] | | Equivalent Units[2] |
| Firm orders - USA | $ 545,987 | 1,208 | $ 585,517 | 1,305 | $ 694,141 | 1,518 |
| Firm orders – Canada | 25,031 | 59 | 72,390 | 171 | 138,517 | 379 |
| Total firm orders[5] | 571,018 | 1,267 | 657,907 | 1,476 | 832,658 | 1,897 |
| Options – USA | 1,979,507 | 4,706 | 2,204,229 | 5,286 | 2,761,784 | 6,610 |
| Options - Canada | 102,323 | 240 | 139,275 | 335 | 83,713 | 205 |
| Total options[6] | 2,081,830 | 4,946 | 2,343,504 | 5,621 | 2,845,497 | 6,815 |
| Total Backlog | $ 2,652,847 | 6,213 | $ 3,001,411 | 7,097 | $ 3,678,155 | 8,712 |

| Equivalent Units in Backlog (unaudited) | 26 Weeks Ended July 1, 2012 | | 52 Weeks Ended January 1, 2012 | | 52 Weeks Ended January 2, 2011 | |
|---|---|---|---|---|---|---|
| | Firm orders | Options | Firm orders | Options | Firm orders | Options |
| Beginning of period | 1,476 | 5,621 | 1,897 | 6,815 | 2,082 | 6,908 |
| New orders | 118 | — | 182 | 477 | 1,013 | 914 |
| Options exercised | 556 | (556) | 1,208 | (1,208) | 825 | (825) |
| Shipments | (883) | — | (1,811) | — | (2,023) | — |
| Cancelled/expired | — | (119) | — | (463) | — | (182) |
| End of period | 1,267 [5] | 4,946 [6] | 1,476 | 5,621 | 1,897 | 6,815 |

Options included in the backlog expire, if not exercised, as follows:

| | |
|---|---|
| 2012 | 881 |
| 2013 | 2,929[6] |
| 2014 | 510 |
| 2015 | 510 |
| 2016 | 26 |
| 2017 | 90 |
| Total options | 4,946 [6] |

_(1) 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 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 and/or the Issuer.

(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) Net earnings (loss) per share (basic) have been retrospectively adjusted to reflect the 10:1 share consolidation that occurred on September 30, 2011.

(4) Finished goods are comprised of completed buses ready for delivery and bus deliveries in-transit.

(5) Included in the Company’s total firm order backlog are 240 EUs under a major U.S. customer order. Based on recent discussions with this customer, it is uncertain whether any of these 240 EUs will enter the Company’s production schedule in the near term or at all.

(6) Included in the Company’s total option backlog are 1,560 option EUs under a major U.S. customer order. Based on recent discussions with this customer, it is uncertain whether any of these 1,560 option EUs will be exercised prior to their expected expiry in 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 and a valuation metric 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 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 Ended July 1, 2012 | 13-Weeks Ended July 3, 2011 | 26-Weeks Ended July 1, 2012 | 26-Weeks Ended July 3, 2011 | 52-weeks Ended July 1, 2012 | 52-weeks Ended July 3, 2011 |
|---|---|---|---|---|---|---|
| Net (loss) earnings | $ 3,604 | $ (7,319) | $ 6,331 | $ (13,680) | $ 39,208 | $ (30,518) |
| Addback[1] | | | | | | |
| Income taxes (recovered) | (1,984) | 817 | (2,726) | 3,454 | 1,311 | (709) |
| Finance cost | 4,228 | 13,433 | 7,899 | 26,596 | 23,269 | 52,352 |
| Amortization | 5,899 | 5,954 | 11,921 | 11,906 | 24,258 | 24,261 |
| Gain on disposal of property, plant and equipment | — | — | — | — | 35 | (7) |
| Fair value adjustment to embedded derivatives | — | 6,172 | 1,395 | 2,505 | 43 | 366 |
| Unrealized foreign exchange loss on non-current monetary items and forward foreign exchange contracts | (692) | (292) | 267 | 8,927 | (9,595) | 28,259 |
| EBITDA[2] | 11,055 | 18,765 | 25,087 | 39,708 | 78,529 | 74,004 |
| Costs associated with assessing strategic and corporate initiatives[7] | 154 | 1,272 | 169 | 2,318 | 596 | 2,318 |
| Loss on exercise of redemption right[10] | 5,530 | — | 5,530 | — | 5,530 | — |
| Loss on debt repurchase[6] | — | — | — | — | 4,722 | — |
| Realized (unrealized) investment tax credits[8] | (373) | — | 504 | — | (20,026) | — |
| Past service pension costs[9] | — | — | 1,762 | — | 1,762 | — |
| Warranty expense assumed from the ISE bankruptcy[5] | — | — | — | — | — | 8,684 |
| Business acquisition related cost[3] | — | — | — | — | — | 5 |
| Adjusted EBITDA[2] | $ 16,366 | $ 20,037 | $ 33,052 | $ 42,026 | $ 71,113 | $ 85,011 |

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

| (Unaudited, US dollars in thousands) | 13-Weeks Ended July 1, 2012 | 13-Weeks Ended July 3, 2011 | 26-Weeks Ended July 1, 2012 | 26-Weeks Ended July 3, 2011 | 52-weeks Ended July 1, 2012 | 52-weeks Ended July 3, 2011 |
|---|---|---|---|---|---|---|
| Net cash generated by (used in) operations | $ (8,073) | $ 14,096 | $ 4,888 | $ (36,341) | $ 2,759 | $ 38,283 |
| Addback(1) | | | | | | |
| Changes in non-cash working capital items | 16,179 | (10,460) | 10,086 | 41,498 | 30,724 | (24,669) |
| Defined benefit funding | 863 | 1,336 | 2,534 | 2,469 | 4,935 | 5,136 |
| Defined benefit expense | (438) | (457) | (2,677) | (913) | (3,585) | (1,472) |
| Interest paid | 4,441 | 12,859 | 8,611 | 26,533 | 25,503 | 52,338 |
| Loss on exercise of redemption right(10) | (5,530) | — | (5,530) | — | (5,530) | — |
| Loss on debt repurchase | — | — | — | — | (4,722) | — |
| Realized (unrealized) investment tax credits | 373 | — | (504) | — | 20,026 | — |
| Warranty expense assumed from the ISE bankruptcy | — | — | — | — | — | (8,684) |
| Foreign exchange gain on cash held in foreign currency | (112) | 262 | 97 | 2,022 | 149 | 3,981 |
| Income taxes paid(4) | 3,352 | 1,129 | 7,582 | 4,440 | 8,270 | 9,091 |
| EBITDA(2) | 11,055 | 18,765 | 25,087 | 39,708 | 78,529 | 74,004 |
| Costs associated with assessing strategic and corporate initiatives(7) | 154 | 1,272 | 169 | 2,318 | 596 | 2,318 |
| Loss on exercise of redemption right(10) | 5,530 | — | 5,530 | — | 5,530 | — |
| Loss on debt repurchase(6) | — | — | — | — | 4,722 | — |
| Realized (unrealized) investment tax credits(8) | (373) | — | 504 | — | (20,026) | — |
| Past service pension costs(9) | — | — | 1,762 | — | 1,762 | — |
| Warranty expense assumed from the ISE bankruptcy(5) | — | — | — | — | — | 8,684 |
| Business acquisition related cost(3) | — | — | — | — | — | 5 |
| Adjusted EBITDA(2) | $ 16,366 | $ 20,037 | $ 33,052 | $ 42,026 | $ 71,113 | $ 85,011 |

(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 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 and/or the Issuer.

(3) Normalized to exclude non-recurring expenses related to the acquisition of certain assets and business of TCB Industries, LLC.

(4) 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.

(5) Normalized to exclude the non-recurring item related to warranty expense assumed as a result of ISE’s bankruptcy.

(6) Normalized to exclude the non-recurring loss related to the repurchase of a portion of the Subordinated Notes.

(7) Normalized to exclude non-recurring expenses related to the costs of assessing strategic and corporate initiatives.

(8) The Company recognizes investment tax credits in Adjusted EBITDA only during the period in which they are applied against income taxes payable.

(9) On March 31, 2012 the Company signed a new collective bargaining agreement that included changes to the Company’s defined benefit pension plan. The effect of the pension plan amendments were to increase the accrued benefit liability and the expected annual pension plan expense in 2012 Q1 by $1,762 to reflect pension benefits provided to employees for past service.

(10) Normalized to exclude the non-recurring loss on exercise of the redemption right option on the Subordinated Notes.

**SUMMARY OF FREE CASH FLOW**

Management uses Free Cash Flow as a non-IFRS measure to enable investors and analysts to assess New Flyer's ability to pay dividends to common shareholders, service debt, and meet other payment obligations. Free Cash Flow is also a common measure of a company's valuation and liquidity.

The Company generates its Free Cash Flow from its cash flows 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 has a revolving credit facility 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 EBITDA, Adjusted EBITDA and Free Cash Flow".

| (Unaudited, US dollars in thousands) | 13-Weeks Ended July 1, 2012 | 13-Weeks Ended July 3, 2011 | 26-Weeks Ended July 1, 2012 | 26-Weeks Ended July 3, 2011 | 52-weeks Ended July 1, 2012 | 52-weeks Ended July 3, 2011 |
|---|---|---|---|---|---|---|
| Net cash generated by operating activities | $ (8,073) | $ 14,096 | $ 4,888 | $ (36,341) | $ 2,759 | $ 38,283 |
| Changes in non-cash working capital items[3] | 16,179 | (10,460) | 10,086 | 41,499 | 30,724 | (24,667) |
| Interest paid[3] | 4,441 | 12,859 | 8,611 | 26,533 | 25,503 | 52,338 |
| Interest expense[3] | (4,317) | (13,433) | (7,922) | (26,596) | (22,077) | (52,355) |
| Income taxes paid[3] | 3,352 | 1,129 | 7,582 | 4,440 | 8,270 | 9,091 |
| Current income tax (expense) recovered[3] | (5,027) | 3,226 | (4,170) | 386 | (26,203) | (1,997) |
| Principal portion of finance lease payments | (629) | (671) | (1,274) | (1,349) | (2,657) | (2,614) |
| Cash capital expenditures | (610) | (996) | (3,289) | (2,019) | (4,954) | (5,677) |
| Proceeds from sale of redundant assets | — | — | — | — | 35 | 7 |
| Business acquisition related cost [6] | — | — | — | — | — | 5 |
| Costs associated with assessing strategic and corporate initiatives[8] | 154 | 1,272 | 169 | 2,318 | 596 | 2,318 |
| Past service pension costs[9] | — | — | 1,762 | — | 1,762 | — |
| Defined benefit funding[4] | 863 | 1,336 | 2,534 | 2,469 | 4,935 | 5,136 |
| Defined benefit expense[4] | (438) | (457) | (2,677) | (913) | (3,585) | (1,472) |
| Foreign exchange gain on cash held in foreign currency[5] | (112) | 262 | 97 | 2,022 | 149 | 3,981 |
| Free Cash Flow (US$)[1] | 5,783 | 8,163 | 16,397 | 12,449 | 15,257 | 22,376 |
| U.S. exchange rate[2] | 1.0091 | 0.9626 | 1.0027 | 0.9690 | 1.0085 | 0.9968 |
| **Free Cash Flow[1] (C$)** | **5,836** | **7,858** | **16,442** | **12,062** | **15,386** | **22,305** |
| Free Cash Flow per Share (C$)[7] | 0.1315 | 1.5883 | 0.3705 | 2.4380 | 0.3904 | 4.5084 |
| **Declared dividends on Shares (C$)** | **9,542** | **4,896** | **19,084** | **9,791** | **35,341** | **19,582** |
| Declared dividend per Share (C$)[7] | $ 0.2150 | $ 0.9895 | $ 0.4300 | $ 1.9790 | $ 0.8968 | $ 3.9580 |

(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 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 Company's $90.0 million revolving credit facility which is available for use to fund general corporate

requirements including working capital requirements, subject to borrowing capacity restrictions. In accordance with IFRS financial statement presentation, changes in non-cash working capital is now being presented on the consolidated statement of cash flow net of interest and incomes taxes paid, whereas the change in non-cash working capital was previously presented net of accrued interest expense and income taxes.

(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 it should be included in the calculation of Free Cash Flow.

(6) Normalized to exclude non-recurring expenses related to the acquisition of certain assets and business of TCB Industries, LLC.

(7) 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 (including those held in the form of an IDS) using the weighted average over the period. The weighted average number of Shares outstanding for 2012 Q2 and 2012 YTD were both 44,379,070 and 52-week period ended July 1, 2012 was 39,409,675. The weighted average number of Shares outstanding for 2011 Q2, 2011 YTD and 52-week period ended July 3, 2011, were all 4,947,528.

(8) Normalized to exclude non-recurring expenses related to the costs of assessing strategic and corporate initiatives.

(9) On March 31, 2012 the Company signed a new collective bargaining agreement that included changes to the Company's defined benefit pension plan. The effect of the pension plan amendments were to increase the accrued benefit liability and the expected annual pension plan expense in 2012 Q1 by $1,762 to reflect pension benefits provided to employees for past service.

**Dividend Policy**

It is the Board's intent to have a common share dividend policy that is consistent with New Flyer's financial performance and the need 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. Up to the date hereof the Board had declared annual dividend payments of C$0.86 per Share. The previous IDS distribution consisted of an annual dividend payment of C$0.396 per Share and an annual interest payment of C$0.774 per C$5.53 principal amount of Subordinated Notes.

On August 8, 2012, the Board has set a new annual dividend rate of C$0.585 per Share effective for all dividends declared after the redemption of the Subordinated Notes. The Board expects to maintain these dividends on a monthly basis although such distributions are not assured indefinitely.

Compared to other common share issuers listed on the TSX, the Board believes this level of dividend provides investors with an attractive level of current income. This dividend policy reflects a shift from the previous distribution policy, pursuant to which substantially all of New Flyer's available cash flow were distributed to IDS holders prior to the conversion from an IDS structure to a common share structure. The Board believes that this dividend level will enhance the financial flexibility of New Flyer to fund growth capital expenditures, acquisitions and other internal financing needs.

**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 and the U.S. dollar. These fluctuations can represent a significant component of the variations in reported results from one period to the next. The Company's Adjusted EBITDA (which is reported in U.S. dollars) is also exposed to foreign currency fluctuations between reporting periods. For example, assuming the Company's net assets are predominately originating in Canadian dollars and the exchange rate of the Canadian dollar compared to the U.S. dollar depreciates, then the related Adjusted EBITDA that is generated in Canadian dollars would be materially adversely affected as compared to the level determined with the prevailing exchange rate during the previous comparable reporting period. However, Free Cash Flow is less likely to be affected by Canadian/U.S. dollar exchange rate fluctuations given that the Company has other significant Canadian dollar denominated payment requirements which are not included in Adjusted EBITDA, including current income taxes. For that reason, management's strategy is to mitigate foreign currency exposure based on net cash flow rather than Adjusted EBITDA.

As at July 1, 2012, 4.4% (January 1, 2012: 11.0%) of the Company's firm order backlog consisted of orders representing Canadian dollar-denominated revenue. Based on this current backlog position and the Company's historically stable Canadian dollar-denominated operating costs, management expects the Company to generate a net Canadian dollar cash outflow during Fiscal 2012 primarily as a result of the higher percentage of U.S. dollar denominated orders in the Company's backlog.

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 2012 Q2, the Company recorded a realized foreign exchange gain of $1.7 million (2011 Q2: $0.5 million). This was comprised of a $0.7 million gain on settlement of foreign exchange contracts and a $1.0 million foreign currency loss on translation of Canadian dollar denominated operations. During 2012 YTD, the Company realized a $1.1 million gain on settlement of $19.1 million of foreign exchange contracts (excluding the exchange of the $65.0 million proceeds from the Debentures) compared to the $1.4 million gain on settlement of $63.8 million of foreign exchange contracts in 2011 YTD.

At July 1, 2012, the Company had $18.0 million foreign exchange forward contracts to buy Canadian dollars that range in expiry from July to September 2012. The related liability of $0.07 million (2011 Q2: $0.1 million asset) is recorded on the statement of financial position as a current derivative financial instruments asset and the corresponding change in the fair value of the foreign exchange forward contracts has been recorded in the condensed consolidated statement of net earnings (loss) and comprehensive income (loss).

**Fiscal and Interim Periods**

The Company's Fiscal 2012 period is divided in quarters. The following table summarizes the number of weeks in the fiscal and interim periods presented for the Company:

| | Period from January 2, 2012 to December 30, 2012 ("Fiscal 2012") | | Period from January 3, 2011 to January 1, 2012 ("Fiscal 2011") | |
|---|---|---|---|---|
| | Period End Date | # of Weeks | Period End Date | # of Weeks |
| Quarter 1 | April 1, 2012 | 13 | April 3, 2011 | 13 |
| Quarter 2 | July 1, 2012 | 13 | July 3, 2011 | 13 |
| Quarter 3 | September 30, 2012 | 13 | October 2, 2011 | 13 |
| Quarter 4 | December 30, 2012 | 13 | January 1, 2012 | 13 |
| Fiscal year | December 30, 2012 | 52 | January 1, 2012 | 52 |

**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.

| (Unaudited, US dollars in thousands) | 2012 Q2 (13-Weeks) | 2011 Q2 (13-Weeks) | 2012 YTD (26-Weeks) | 2011 YTD (26-Weeks) |
|---|---|---|---|---|
| Bus Manufacturing Revenue | $ 197,369 | $ 194,723 | $ 393,602 | $ 382,181 |
| Aftermarket Revenue | 29,611 | 31,130 | 61,022 | 58,016 |
| Total Revenue | $ 226,980 | $ 225,853 | $ 454,624 | $ 440,197 |
| Earnings from operations | 10,686 | 12,811 | 18,696 | 27,802 |
| Earnings before interest and income taxes | 5,848 | 6,931 | 11,504 | 16,370 |
| Earnings (loss) before income taxes | 1,620 | (6,502) | 3,605 | (10,226) |
| Net (loss) earnings for the period | 3,604 | (7,319) | 6,331 | (13,680) |

***Revenue***

The Company achieved consolidated revenue of $227.0 million for 2012 Q2, an increase of 0.5% compared to consolidated revenue for 2011 Q1 of $225.9 million, and consolidated revenue for 2012 YTD of $454.6 million, an increase of 3.3% from consolidated revenue for 2011 YTD of $440.2 million.

Revenue from bus manufacturing operations for 2012 Q2 was $197.4 million, an increase of 1.4% from $194.7 million in 2011 Q2, and revenue of $393.6 million for 2012 YTD increased 3.0% from $382.2 million for 2011 YTD. The increase in 2011 Q2 revenue primarily resulted from a 2.3% increase in total bus deliveries of 441 EUs in 2012 Q2 compared to 2011 Q2 deliveries of 431 EUs, offset by a 0.9% decrease in average selling price per EU in 2012 Q2 compared to 2011 Q2. The average selling price per EU in 2012 Q2 was $447.5 thousand which decreased slightly compared to $451.8 thousand in 2011 Q2. The decrease in average bus selling price is attributed to the continued price pressure and a mix of products sold with a lower selling price, primarily articulated buses. Bus deliveries in 2012 YTD totaled 883 EUs, a decrease of 1.8% compared to 899 EUs in 2011 YTD. The 2012 YTD decrease is partly due to lower production rates in 2012 YTD compared to 2011 YTD to meet management's plan for a sustainable production rate for the 2012 fiscal year, while the average selling price per EU in 2012 YTD was $445.8 thousand, an increase from $425.1 thousand in 2011 YTD.

Revenue from aftermarket operations (excluding used bus sales) in 2012 Q2 was $29.3 million as compared to $29.2 million in 2011 Q2. Used bus sales in 2012 Q2 were $0.3 million compared to $1.9 million in 2011 Q2. Revenue from aftermarket operations (excluding used bus sales) for 2012 YTD of $60.5 million, an increase of 7.8% compared to $56.1 million in 2011 YTD. Used bus sales in 2012 YTD were $0.6 million compared to $1.9 million in 2011 YTD.

***Cost of sales***

The consolidated cost of sales for 2012 Q2 of $208.3 million increased 2.7% from 2011 Q2 consolidated cost of sales of $202.8 million. 2012 YTD consolidated cost of sales of $416.2 million increased by 6.6% from 2011 YTD of $390.3 million.

Costs of sales from bus manufacturing operations consist of direct contract costs and manufacturing overhead. The cost of sales from bus manufacturing operations for 2012 Q2 were $186.6 million, an increase of 2.8% compared to $181.4 million in 2011 Q2. The cost of sales from bus manufacturing operations of $371.7 million in 2012 YTD increased by 6.2% as compared to $350.2 million in 2011 YTD. The increase in cost of sales from bus manufacturing operations for 2012 YTD partially relates to the corresponding increase in revenue resulting from a sales mix comprised of higher costing buses, as evidenced by the 4.9% increase in selling price when comparing the two periods and the impact of the signing bonus and increased pension benefit resulting from the recently negotiated CBA.

The cost of sales from aftermarket operations were $21.7 million in 2012 Q2 which increased 1.3% compared to $21.4 million in 2011 Q2, and $44.4 million in 2012 YTD as compared to $40.1 million in 2011 YTD, an increase of 10.7%. The increase in aftermarket operations cost of sales for 2012 YTD primarily relates to the increase in sales volumes and a mix of higher dollar items sold when comparing the two periods.

***Selling, general and administration costs and other operating expenses ("SG&A")***

The consolidated SG&A for 2012 Q2 of $9.9 million decreased 7.6% compared with $10.7 million in 2011 Q2. Consolidated SG&A expenses for 2012 YTD were $21.4 million which decreased 7.8% compared to $23.2 million in 2011 YTD. The decrease is primarily a result of 2011 Q2 SG&A costs included $1.3 million of incremental costs to assess strategic and corporate initiatives and $2.3 million in 2011 YTD SG&A costs.

***Realized foreign exchange loss (gain)***

In 2012 Q2, the Company recognized a net realized gain of $1.8 million as compared with a net realized gain of $0.5 million in 2011 Q2 primarily as a result of the favourable settlement of foreign exchange transactions and realization of foreign exchange gains and losses on working capital accounts. Similarly, in 2012 YTD the Company recognized a net realized gain of $1.7 million as compared with a net realized gain of $1.1 million in 2011 YTD.

***Earnings from operations***

Consolidated earnings from operations for 2012 Q2 in the amount of $10.7 million (4.7% of revenue) decreased 16.6% compared to earnings from operations in 2011 Q2 of $12.8 million (5.7% of revenue). 2012 YTD consolidated earnings from operations were $18.7 million (4.1% of revenue), which represents a 32.7% decrease as compared to $27.8 million (6.3% of revenue) in 2011 YTD.

The earnings from bus manufacturing operations (including amortization and depreciation) for 2012 Q2 were $5.6 million, an increase of 3.6% compared to earnings of $5.4 million for 2011 Q2 (both periods were 2.8% of bus manufacturing revenue). 2012 YTD earnings from bus manufacturing operations were $7.9 million (2.0% of revenue), a decrease of 46.9% compared to $14.8 million (3.9% of revenue)

in 2011 YTD, which is a primarily result of the one-time pension and wage benefits provided under the new CBA. Whereas, 2011 YTD benefited from incremental vendor rebates of $2.5 million and a $2.0 million favourable foreign currency impact offset by $0.9 million of severance costs and $1.0 of incremental costs to assess strategic and corporate initiatives. The benefits of the unused investment tax credits are expected to be realized in future periods.

The earnings from aftermarket operations of $5.1 million in 2012 Q2 decreased 31.0% compared to 2011 Q2 earnings of $7.4 million. 2012 Q2 aftermarket operations margin of 17.1% decreased in comparison to 23.6% in 2011 Q2, primarily due to $0.9 million contribution from the used bus sales in 2011 Q2 and the increased operating costs of the newer parts distribution centers required to achieve future revenue growth. In 2012 YTD, the earnings from aftermarket operations were $10.8 million (17.7% of revenue), compared to $13.0 million (22.3% of revenue) in 2011 YTD. The decrease is primarily due to the used bus sales and the general tightening of margins during the period.

***Unrealized foreign exchange (gain) loss***

Unrealized foreign currency (gain) losses arise primarily from the revaluation of the Canadian dollar-denominated long-term debt. In 2012 Q2, the Company recognized a net unrealized gain of $0.7 million compared to a net unrealized gain of $0.3 million in 2011 Q2. These results consist of the following:

| (Unaudited, US dollars in thousands) | 2012 Q2 | 2011 Q2 | 2012 YTD | 2011 YTD |
|---|---|---|---|---|
| Unrealized (gain) loss on Canadian–denominated long-term debt | $ (1,244) | $ (34) | $ (120) | $ 9,865 |
| Unrealized (gain) loss on forward foreign exchanges contracts | 97 | (223) | 211 | (688) |
| Unrealized (gain) loss on other non-monetary assets/liabilities | 455 | (35) | 176 | (250) |
| | $ (692) | $ (292) | $ 267 | $ 8,927 |

***Earnings before finance costs and income taxes ("EBIT")***

In 2012 Q2, the Company recorded EBIT of $5.8 million compared to EBIT of $6.9 million in 2011 Q2. EBIT has been impacted by non-cash and non-recurring items as follows:

| (Unaudited, US dollars in thousands) | 2012 Q2 | 2011 Q2 | 2012 YTD | 2011 YTD |
|---|---|---|---|---|
| Non-cash and non-recurring charges (recovery): | | | | |
| Costs associated with assessing strategic and corporate initiatives | $ 154 | $ 1,272 | $ 169 | $ 2,318 |
| Fair value adjustment to embedded derivatives | — | 6,172 | 1,395 | 2,505 |
| Unrealized foreign exchange (gain) loss | (692) | (292) | 267 | 8,927 |
| Realized (unrealized) investment tax credits | (373) | — | 504 | — |
| Past service pension costs | — | — | 1,762 | — |
| Loss on exercise of redemption right | 5,530 | — | 5,530 | — |
| Amortization | 5,899 | 5,954 | 11,921 | 11,906 |
| Total Non-cash and non-recurring charges: | $ 10,518 | $ 13,106 | $ 21,548 | $ 25,656 |

Absent these non-cash and non-recurring charges, the 2012 Q2 EBIT would have been $16.4 million compared to $20.0 million in 2011 Q2.

***Finance costs***

The finance costs for 2012 Q2 were $4.2 million, compared to $13.4 million in 2011 Q2, and $7.9 million in 2012 YTD, a decrease of compared to $26.6 million in 2011 YTD. Finance costs for 2012 YTD decreased by $18.7 million primarily due to decrease in the interest on the Subordinated Notes as a result of certain Subordinated Notes repurchased in November 2011 and as part of NFI's August 2011 non-cash rights offering, partially offset by $0.3 million of interest on the Debentures. The company recognizes that during the interim period between June 5, 2012, when the Debentures were issued and August 20, 2012 when the Subordinated Notes will be redeemed, there exists duplicative interest of $0.5 million.

***Earnings (loss) before income taxes***

Earnings before income taxes ("EBT") for 2012 Q2 was $1.6 million compared to a loss before income taxes of $6.5 million in 2011 Q2 and EBT for 2012 YTD was $3.6 million compared to a loss before income taxes of $10.2 million in 2011 YTD. The increase in the EBT between these periods results primarily from the decrease in finance costs.

***Income taxes***

The income tax expense recovered for 2012 Q2 was $2.0 million, consisting of $5.0 million of current income tax expense and $7.0 million of deferred income tax expense recovered. In comparison, the income tax expense for 2011 Q2 was $0.8 million, which consists of $3.2 million of current income tax expense recovered and $4.0 million of deferred income tax expense. The income tax expense recovered for 2012 YTD was $2.7 million, consisting of $4.2 million of current income tax expense and $6.9 million of deferred income tax expense recovered. In comparison, the income tax expense for 2011 YTD was $3.5 million, consisting of $0.4 million of current income tax expense recovered and $3.8 million of deferred income tax expense. The current income tax expense increased primarily as a result of increased Canadian taxable income without the previous benefit of loss carryforwards, whereas the deferred income tax recovered increased in the current period due to the exercise of the redemption right.

***Net earnings (loss)***

The Company reported net earnings of $3.6 million in 2012 Q2 compared to a net loss of $7.3 million in 2011 Q2. The increase in net earnings in 2012 Q2 is primarily attributable to the increase in earnings before income taxes and a decrease in income taxes as noted above. The Company's net earnings (losses) can be subject to a high degree of volatility from one fiscal period to the next as a result of non-cash accounting adjustments and income taxes. Similarly, 2012 YTD net earnings of $6.3 million increased compared to 2011 YTD net loss of $13.7 million.

***Cash Flow***

The cash flows of the Company are summarized as follows:

| (Unaudited, US dollars in thousands) | 2012 Q2 | 2011 Q2 | 2012 YTD | 2011 YTD |
|---|---|---|---|---|
| Cash generated by operating activities before non-cash working capital items and interest and income taxes paid | $ 15,899 | $ 17,624 | $ 31,167 | $ 36,130 |
| Changes in non-cash working capital items | (16,179) | 10,460 | (10,086) | (41,498) |
| Interest paid | (4,441) | (12,859) | (8,611) | (26,533) |
| Income taxes paid | (3,352) | (1,129) | (7,582) | (4,440) |
| Cash flow from operating activities | (8,073) | 14,096 | 4,888 | (36,341) |
| Cash flow from financing activities | 70,062 | (6,033) | 57,928 | (11,373) |
| Cash flow from investing activities | $ (2,191) | $ (996) | $ (5,851) | $ (2,650) |

***Cash flows from operating activities***

The 2012 Q2 net operating cash outflow of $8.1 million is the result of an increase in non-cash working capital of $16.2 million offset by $8.1 million of net cash earnings, compared to 2011 Q2 net operating cash inflow of $14.1 million is the result of $3.6 million of net cash earnings and a decrease of $10.5 in non-cash working capital.

The 2012 YTD net cash operating inflow of $4.9 million is the result of $15.0 million of net cash earnings and offset by an increase of $10.1 million in non-cash working capital compared to 2011 YTD net cash operating outflow of $36.3 million resulting from an increase of $41.5 million in working capital, offset by $36.1 million of net cash earnings. The 2012 YTD non-cash working capital changes that are primarily responsible for the significant outflow during the period are due to decreased accounts payables, income taxes payable and provision for warranty costs.

***Cash flow from financing activities***

The Company's financing activities resulted in a net cash inflow of $70.1 million during 2012 Q2 compared to outflows of $6.0 million in 2011 Q2 as a result of receiving the net proceeds from issuance of Debentures which will be used to redeem the Subordinated Notes on August 20, 2012.

The Company's financing activities for 2012 YTD resulted in a net cash inflow of $57.9 million, compared to 2011 YTD net cash outflow of $11.4 million. The increased inflow primarily relates to the net proceeds received from the issuance of Debentures and increased draws on bank revolver and term loans, offset somewhat by $9.0 million of increased dividends paid as a result of the August 2011 non-cash rights offering. The company has been accessing its delayed draw term loan component of the Credit Facility to make planned growth capital expenditures to improve manufacturing efficiencies.

***Cash flow from investing activities***

2012 Q2 investing activities resulted in a net cash outflow of $2.2 million compared to $1.0 million in 2011 Q2. 2012 Q2 investing activities also include the acquisition of $0.1 million of intellectual property relating to New Flyer Connect™.

The composition of the capital expenditures was as follows:

| (Unaudited, US dollars in thousands) | 2012 Q2 | 2011 Q2 | 2012 YTD | 2011 YTD |
|---|---|---|---|---|
| Capital expenditures | $ 2,352 | $ 1,155 | $ 6,012 | $ 2,570 |
| Less capital expenditures funded by bank loans | (1,448) | — | (2,428) | — |
| Less capital expenditures funded by capital leases | (294) | (159) | (295) | (551) |
| Cash capital expenditure | 610 | 996 | 3,289 | 2,019 |
| | | | | |
| Comprised of: | | | | |
| Maintenance capital expenditures | 443 | 464 | 750 | 898 |
| Growth capital expenditures | 167 | 532 | 2,539 | 1,121 |
| | $ 610 | $ 996 | $ 3,289 | $ 2,019 |

***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 including 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, existing credit facilities, 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 revolving credit facility in order to meet its working capital requirements. Management believes that there is a continuing trend by transit authorities to move away from milestone payments that were traditionally seen as regular business terms and requesting payment after final delivery.

The Company generated Free Cash Flow of C$5.8 million during 2012 Q2 while declaring dividends of C$9.5 million as compared to C$7.9 million of Free Cash Flow generated in 2011 Q2 and declared dividends of C$4.9 million. During 2012 YTD, New Flyer generated Free Cash Flow of C$16.4 million while declaring dividends of C$19.1 million as compared to C$12.1 million of Free Cash Flow generated in 2011 YTD and declared dividends of C$9.8 million. Although, the current Free Cash Flow generated is not sufficient,

provisions have been made to sustain dividends until August 2012 when the Board reduced the annualized dividend payment to C$0.585 per Share. See “Dividend Policy”. The reduced dividend is expected to produce an annual improvement in cash flows of C$12.2 million, based on the current number of Shares outstanding.

During 2012 Q2, the Company increased its cash by $59.7 million, primarily due to $61.2 million of net cash generated by the issuance of the Debentures which will be used to redeem the Subordinated Notes on August 20, 2012 and increase in delayed draw term loan, offset by $2.1 million invested in new equipment. The Company continues to invest in machinery and equipment that improves efficiency and provides enhanced insourcing capabilities. Funding for these growth capital expenditures have been through a mix of cash and utilization of the Company’s delayed draw term loan.

The July 1, 2012 liquidity position of $61.1 million is comprised of available cash of $5.5 million (as $61.7 million of the $67.2 million of cash on hand has been earmarked for redemption of the Subordinated Notes) and $55.6 million of available secured revolving credit facility. As at July 1, 2012, there were $21.0 million of direct borrowings and $13.4 million of outstanding letters of credits related to the $90.0 million of secured revolving credit. 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 and future 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 a fixed charge coverage ratio, senior leverage ratio and total leverage ratio. On August 20, 2012, the fixed charge coverage ratio will be replaced by an interest coverage ratio of not less than 3.00 and the total leverage ratio will be changed to less than 3.25 and will not include the Debentures. At July 1, 2012, the Company is in compliance with the new and revised ratios.

As at July 1, 2012, the Company is in compliance with the financial covenants in the Credit Facility.  The results of the financial covenants tests as of such date are as follows:

| | **July 1, 2012** | **April 1, 2012** | **January 1, 2012** |
|---|---|---|---|
| Senior Leverage Ratio (must be less than 2.50) | 1.03 | 1.53 | 1.43 |
| Total Leverage Ratio (must be less than 3.75) * | 1.84 | 2.32 | 2.15 |
| Fixed Charge Coverage Ratio (must be greater than 1.10) | 1.63 | 1.53 | 1.26 |

* Decreased from 4.75 effective June 25, 2012 as per Amended Credit Facility

***Interest rate risk***

In connection with the Credit Facility, the Company has an interest rate swap designed to hedge floating rate exposure to manage interest rate risk relating to potentially adverse changes in the LIBOR rate on $90.0 million out of the $116.0 million of the drawn term credit facility. The interest rate swap fixes the interest rate at 1.90% plus the applicable interest margin until April 2014. The fair value of the interest rate swap liability of $2,542 at July 1, 2012 (January 1, 2012: $2,811) 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, as 80% of the capital cost of new buses typically come from the U.S. Federal Transit Administration, 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 (loss) and comprehensive income (loss).

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

| | July 1, 2012 | January 1, 2012 |
|---|---|---|
| Current, including holdbacks | $ 105,220 | $ 110,563 |
| Past due amounts but not impaired | | |
| 1 – 60 days | 2,690 | 2,671 |
| Greater than 60 days | 837 | 2,665 |
| Less: Allowance for doubtful accounts | (57) | (49) |
| Total accounts receivables, net | $ 108,690 | $ 115,850 |

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***

As at July 1, 2012, outstanding surety bonds guaranteed by the Company amounted to $44.4 million, representing an increase compared to $42.3 million at April 1, 2012. 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 July 1, 2012, letters of credit amounting to $13.4 million remained outstanding under the letter of credit.

**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 7 Financial Instruments: Disclosures, Amendment regarding Disclosures with respect to Offsetting:

The disclosure requirements have also been amended with respect to offsetting financial assets and financial liabilities to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Retrospective application is required, for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. Management has not yet evaluated the impact on the financial statements.

As part of the above IFRS 7 amendment, aspects of IAS 32 Financial Instruments: Presentation, was also clarified. The amendments to IAS 32 address inconsistencies in current practice when applying the requirements. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively. Management has not yet evaluated the impact on the financial statements.

IFRS 9 Financial Instruments:

This standard replaces the current IAS 39 Financial Instruments Recognition and Measurement. The Company will start the application of IFRS 9 in the financial statements effective January 1, 2015. Management has not yet evaluated the impact on the financial statements.

IAS 19 (Revised 2011) Employee Benefits:

The main changes to the standard are the elimination of the corridor approach (with all changes to the defined benefit obligation and plan assets recognized when they occur) and calculation of net interest using a high quality corporate bond yield. Retrospective

application is required with certain exceptions, effective January 1, 2013. Management has not yet evaluated the impact on the financial statements.

IFRS 13 Fair Value Measurement:

IFRS 13 establishes a single framework for fair value measurement as required by other IFRS standards and is applicable to both financial and non-financial items that are required or permitted by other standards to be measured at fair value, effective January 1, 2013. Prospective application is required. Management has not yet evaluated the impact on the financial statements.

IAS 1 (Revised 2011) Presentation of Financial Statements:

Disclosure of other comprehensive income items between those that are recycled to profit or loss and those not recycled is required with retrospective application, effective July 1, 2012. The Company does not expect any material impact to the financial statements as a result of adopting this standard.

IFRS 10 Consolidated Financial Statements:

The new standard uses control as the single basis of consolidation for all entities with three elements to control: power over an investee; exposure or rights to variable returns; and the ability to affect returns. Retrospective application is required, subject to certain transitional provisions, effective January 1, 2013. Management has not yet evaluated the impact on the financial statements.

IFRS 11 Joint Arrangements:

The new standard classifies arrangements as either joint operations or joint ventures. All interests in joint ventures should now be accounted for based on the equity method. Transitional provisions vary depending on how an interest is classified under IAS 31, effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

IFRS 12 Disclosure of Interest in Other Entities:

IFRS 12 requires extensive disclosure relating to an entity's interest in subsidiaries, joint arrangements, associates and unconsolidated structure entities. Incorporation of disclosure is permitted, without early adoption of IFRS 12, IFRS 10, IFRS 11, IAS 27 (as amended 2011) and IAS 28 (as amended 2011), effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

IAS 27 (as amended 2011) Separate Financial Statements:

IAS 27 (2011) provides guidance on the accounting and disclosure requirements for subsidiaries, jointly controlled entities, and associates in separate, or unconsolidated, financial statements, effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

IAS 28 (as amended 2011) Investments in Associates:

The amended IAS 28 (2011) provides detailed guidance on the application of the equity method to associates, subsidiaries and joint ventures (previously excluded from this standard), effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

**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 generally accepted accounting principles. Management, under the supervision of the CEO and CFO, evaluated the design of the Company's ICFR as of January 1, 2012 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.

There have been no changes in the Company's ICFR during the most recent interim period 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 January 1, 2012 were effective.

Interim Condensed Consolidated Financial Statements of

# NEW FLYER INDUSTRIES INC.

July 1, 2012

(Unaudited)

## TABLE OF CONTENTS


| | Page # |
|---|---|
| Unaudited interim Condensed Consolidated Statements of Net Earnings (Loss) and Comprehensive Income (Loss) | 1 |
| Unaudited interim Condensed Consolidated Statements of Financial Position | 2 |
| Unaudited interim Condensed Consolidated Statement of Changes in Equity | 3 |
| Unaudited interim Condensed Consolidated Statements of Cash Flows | 4 |
| Notes to Unaudited interim Condensed Consolidated Financial Statements | 5 - 18 |

# NEW FLYER INDUSTRIES INC.

**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS)**
**For the period ended July 1, 2012**
(unaudited, in thousands of U.S. dollars except per share figures)

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Revenue (note 13) | $ 226,980 | $ 225,853 | $ 454,624 | $ 440,197 |
| Cost of sales (note 4) | 208,265 | 202,830 | 416,161 | 390,318 |
| **Gross profit** | 18,715 | 23,023 | 38,463 | 49,879 |
| Sales, general and administration costs and other operating expenses | 9,877 | 10,691 | 21,429 | 23,225 |
| Foreign exchange gain (note 12b) | (1,848) | (479) | (1,662) | (1,148) |
| **Earnings from operations** | 10,686 | 12,811 | 18,696 | 27,802 |
| Unrealized foreign exchange (gain) loss on non-current monetary items | (692) | (292) | 267 | 8,927 |
| Loss on exercise of redemption right (note 6) | 5,530 | — | 5,530 | — |
| Fair value adjustment to embedded derivatives | — | 6,172 | 1,395 | 2,505 |
| **Earnings before interest and income taxes** | 5,848 | 6,931 | 11,504 | 16,370 |
| **Finance costs** | | | | |
| Interest on long-term debt and convertible debentures | 3,395 | 12,990 | 6,482 | 26,007 |
| Accretion in carrying value of long-term debt and convertible debentures | 128 | 245 | 246 | 484 |
| Other interest and bank charges | 922 | 497 | 1,440 | 830 |
| Fair value adjustment on interest rate swap | (217) | (299) | (269) | (725) |
| | 4,228 | 13,433 | 7,899 | 26,596 |
| **Earnings (loss) before income tax expense** | 1,620 | (6,502) | 3,605 | (10,226) |
| **Income tax expense (recovered)** (note 5) | | | | |
| Current income taxes (recovered) | 5,027 | (3,226) | 4,170 | (386) |
| Deferred taxes (recovered) | (7,011) | 4,043 | (6,896) | 3,840 |
| | (1,984) | 817 | (2,726) | 3,454 |
| **Net earnings (loss) for the period** | $ 3,604 | $ (7,319) | $ 6,331 | $ (13,680) |
| **Other comprehensive loss for the period, net of tax** | | | | |
| Actuarial loss on defined benefit pension plan | — | — | 80 | — |
| **Total comprehensive income (loss) for the period** | 3,604 | (7,319) | 6,251 | (13,680) |
| **Net earnings (loss) per share (basic)** (note 9) | $ 0.08 | $ (1.48) | $ 0.14 | $ (2.77) |
| **Net earnings (loss) per share (diluted)** (note 9) | $ 0.07 | $ (1.48) | $ 0.12 | $ (2.77) |

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**

**July 1, 2012**

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

| | | July 1, 2012 | | January 1, 2012 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash (note 6) | $ | 67,195 | $ | 10,133 |
| Accounts receivable (note 3,12d) | | 108,690 | | 115,850 |
| Inventories (note 4) | | 93,763 | | 93,491 |
| Derivative financial instruments (note 12b) | | — | | 145 |
| Prepaid expenses and deposits | | 3,737 | | 5,077 |
| | | 273,385 | | 224,696 |
| Property, plant and equipment | | 39,617 | | 37,397 |
| Long-term receivable | | 2,965 | | — |
| Embedded derivative instruments (note 12b) | | — | | 3,684 |
| Unused investment tax credits | | 23,262 | | 23,766 |
| Deferred tax assets (note 5) | | 49,066 | | 36,558 |
| Goodwill and intangible assets | | 536,499 | | 544,361 |
| | $ | 924,794 | $ | 870,462 |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payable and accrued liabilities | $ | 144,696 | $ | 152,207 |
| Income taxes payable | | 760 | | 4,964 |
| Deferred revenue | | 1,591 | | 1,897 |
| Provisions for warranty costs (note 15) | | 26,297 | | 32,808 |
| Current portion of long-term debt (note 6) | | 81,664 | | 9,000 |
| Derivative financial instruments (note 12b) | | 66 | | — |
| Current portion of deferred compensation obligation | | — | | 1,404 |
| Current portion of obligations under finance leases | | 2,099 | | 2,377 |
| | | 257,173 | | 204,657 |
| Accrued benefit liability | | 9,461 | | 9,136 |
| Obligations under finance leases | | 1,405 | | 2,102 |
| Deferred compensation obligation | | 755 | | 262 |
| Deferred tax liabilities (note 5) | | 128,302 | | 119,088 |
| Long-term debt (note 6) | | 114,575 | | 166,835 |
| Convertible debentures (note 7) | | 55,949 | | — |
| Derivative financial instruments (note 12b) | | 2,542 | | 2,811 |
| | | 570,162 | | 504,891 |
| **Commitments and contingencies** (note 14) | | | | |
| **Shareholders' equity** | | | | |
| Share capital (note 8) | | 476,918 | | 476,918 |
| Equity component of convertible debentures (note 7) | | 3,753 | | — |
| Deficit | | (126,039) | | (111,347) |
| | | 354,632 | | 365,571 |
| | $ | 924,794 | $ | 870,462 |

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

Authorized for issue by the board of directors on August 8, 2012.

# NEW FLYER INDUSTRIES INC.

**INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

**For the period ended July 1, 2012**

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

| | Share Capital | Equity Component of Convertible Debentures (note 7) | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| **Balance, January 2, 2011** | **$ 226,338** | **$ —** | **$ (99,225)** | **$ 127,113** |
| Net loss and comprehensive loss for the period | — | — | (13,680) | (13,680) |
| Dividends declared on common shares | — | — | (10,076) | (10,076) |
| **Balance, July 3, 2011** | **226,338** | **—** | **(122,981)** | **103,357** |
| Shares issued in exchange for Subordinated Notes included in IDS units on August 19, 2011 | 248,542 | — | — | 248,542 |
| Share issuance costs | (4,600) | — | — | (4,600) |
| Net earnings for the period | — | — | 32,877 | 32,877 |
| Other comprehensive loss for the period | — | — | (1,990) | (1,990) |
| Dividends declared on common shares | — | — | (16,005) | (16,005) |
| Deferred tax assets recognized as a result of historical share issuances | 6,638 | — | (3,248) | 3,390 |
| **Balance, January 1, 2012** | **476,918** | **—** | **(111,347)** | **365,571** |
| Net earnings for the period | — | — | 6,331 | 6,331 |
| Other comprehensive loss for the period | — | — | (80) | (80) |
| Dividends declared on common shares | — | — | (19,006) | (19,006) |
| Equity component of convertible debentures (net of tax $1,509) | — | 3,753 | — | 3,753 |
| Deferred tax assets recognized as a result of share and debt issuances | — | — | (1,937) | (1,937) |
| **Balance, July 1, 2012** | **$ 476,918** | **$ 3,753** | **$ (126,039)** | **$ 354,632** |

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 July 1, 2012**

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

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Cash generated by (used in) | | | | |
| **Operating activities** | | | | |
| Net earnings (loss) for the period | $ 3,604 | $ (7,319) | $ 6,331 | $ (13,680) |
| Income tax (recovered) expense | (1,984) | 817 | (2,726) | 3,454 |
| Depreciation of plant and equipment | 1,901 | 1,956 | 3,925 | 3,921 |
| Amortization of intangible assets | 3,998 | 3,998 | 7,996 | 7,985 |
| Finance costs recognized in profit or loss | 4,228 | 13,433 | 7,899 | 26,596 |
| Unrealized foreign exchange (gain) loss on non-current monetary items | (692) | (292) | 267 | 8,927 |
| Foreign exchange gain on cash held in foreign currency | 112 | (262) | (97) | (2,022) |
| Fair value adjustment to embedded derivatives | — | 6,172 | 1,395 | 2,505 |
| Realized (unrealized) investment tax credits | (373) | — | 504 | — |
| Loss on exercise of redemption right (note 6) | 5,530 | — | 5,530 | — |
| Defined benefit expense (note 11) | 438 | 457 | 2,677 | 913 |
| Defined benefit funding | (863) | (1,336) | (2,534) | (2,469) |
| Cash generated by operating activities before non-cash working capital items and interest and income taxes paid | 15,899 | 17,624 | 31,167 | 36,130 |
| Changes in non-cash working capital items (note 10) | (16,179) | 10,460 | (10,086) | (41,498) |
| Cash generated by operations before interest and income taxes paid | (280) | 28,084 | 21,081 | (5,368) |
| Interest paid | (4,441) | (12,859) | (8,611) | (26,533) |
| Income taxes paid | (3,352) | (1,129) | (7,582) | (4,440) |
| Net cash generated by (used in) operating activities | (8,073) | 14,096 | 4,888 | (36,341) |
| **Financing activities** | | | | |
| Repayment of obligations under finance leases | (629) | (671) | (1,274) | (1,349) |
| Proceeds from issue of long-term debt | 19,000 | — | 17,000 | — |
| Proceeds from issue of convertible debentures | 65,000 | — | 65,000 | — |
| Costs associated with convertible debenture issuance | (3,789) | — | (3,789) | — |
| Dividends paid | (9,520) | (5,362) | (19,009) | (10,024) |
| Net cash generated by (used in) financing activities | 70,062 | (6,033) | 57,928 | (11,373) |
| **Investing activities** | | | | |
| Acquisition of intangible assets | (134) | — | (134) | (631) |
| Acquisition of property, plant and equipment | (2,057) | (996) | (5,717) | (2,019) |
| Net cash used in investing activities | (2,191) | (996) | (5,851) | (2,650) |
| Effect of foreign exchange rate on cash | (112) | 262 | 97 | 2,022 |
| **Increase (decrease) in cash** | 59,686 | 7,329 | 57,062 | (48,342) |
| **Cash — beginning of period** | 7,509 | 17,792 | 10,133 | 73,463 |
| **Cash — end of period** | $ 67,195 | $ 25,121 | $ 67,195 | $ 25,121 |

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**
**July 1, 2012**
(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. The Company is the manufacturer of the New Flyer branded heavy-duty transit buses. The business also includes aftermarket support including the sale of bus parts. The Company's principal place of business is Winnipeg, Manitoba, with two other manufacturing facilities in St. Cloud, MN and Crookston, MN (all ISO 9001, ISO 14001 and OHSAS 18001 certified), as well as a bus parts fabrication facility in Elkhart, Indiana. The Company also has four parts distribution centers in Winnipeg, MB, Brampton, ON, Erlanger, KY and Fresno, CA and a service center in Arnprior, ON.

The Company’s common shares (the “Shares”) are listed on the Toronto Stock Exchange (“TSX”) under the symbol "NFI", the income deposit Securities (“IDS”) of the Company and New Flyer Industries Canada ULC (“NFI ULC”) are listed on the TSX under the symbol “NFI.UN” 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 8, 2012.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these Statements is the same as those applied by the Company in its consolidated financial statements as at and for the 52-week period ended January 1, 2012. These Statements should be read in conjunction with the Company’s consolidated financial statements as at and for the 52-week period ended January 1, 2012.

### 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 IFRS which requires management to make judgements, 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 judgements made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those as those applied by the Company in its consolidated financial statements as at and for the 52-week period ended January 1, 2012.

### 2.3 Principles of consolidation

The Statements of the Company include the accounts of all of its subsidiaries; New Flyer Holdings, Inc. (“NFL Holdings”), Transit Holdings, Inc. (“THI”), New Flyer of America Inc. (“NFAI”), NFI ULC, 1176846 Alberta ULC and TCB Enterprises, LLC.

### 2.4 Standards recently adopted

IAS 12 Income Tax, Amendment regarding Deferred Tax: Recovery of Underlying Asset:

IAS 12 Income Taxes is amended to provide a presumption that recovery of the carrying amount of an asset measured using the fair value model in IAS 40 Investment Property will normally be through sale. As a result of the amendments, SIC-21 Income Taxes — Recovery of Revalued Non-Depreciable Assets would no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC-21. The amendments are effective beginning January 1, 2012. There was no material impact to the Statements as a result of adopting this standard.

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

### 2.5 Standards issued but not yet adopted

IFRS 7 Financial Instruments: Disclosures, Amendment regarding Disclosures with respect to Offsetting:

The disclosure requirements have also been amended with respect to offsetting financial assets and financial liabilities to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Retrospective application is required, for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. Management has not yet evaluated the impact on the financial statements.

As part of the above IFRS 7 amendment, aspects of IAS 32 Financial Instruments: Presentation, was also clarified. The amendments to IAS 32 address inconsistencies in current practice when applying the requirements. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively. Management has not yet evaluated the impact on the financial statements.

IFRS 9 Financial Instruments:

This standard replaces the current IAS 39 Financial Instruments Recognition and Measurement. The Company will start the application of IFRS 9 in the financial statements effective January 1, 2015. Management has not yet evaluated the impact on the financial statements.

IAS 19 (Revised 2011) Employee Benefits:

The main changes to the standard are the elimination of the corridor approach (with all changes to the defined benefit obligation and plan assets recognized when they occur) and calculation of net interest using a high quality corporate bond yield. Retrospective application is required with certain exceptions, effective January 1, 2013. Management has not yet evaluated the impact on the financial statements.

IFRS 13 Fair Value Measurement:

IFRS 13 establishes a single framework for fair value measurement as required by other IFRS standards and is applicable to both financial and non-financial items that are required or permitted by other standards to be measured at fair value, effective January 1, 2013. Prospective application is required. Management has not yet evaluated the impact on the financial statements.

IAS 1 (Revised 2011) Presentation of Financial Statements:

Disclosure of other comprehensive income items between those that are recycled to profit or loss and those not recycled is required with retrospective application, effective July 1, 2012. The Company does not expect any material impact to the financial statements as a result of adopting this standard.

IFRS 10 Consolidated Financial Statements:

The new standard uses control as the single basis of consolidation for all entities with three elements to control: power over an investee; exposure or rights to variable returns; and the ability to affect returns. Retrospective application is required, subject to certain transitional provisions, effective January 1, 2013. Management has not yet evaluated the impact on the financial statements.

IFRS 11 Joint Arrangements:

The new standard classifies arrangements as either joint operations or joint ventures. All interests in joint ventures should now be accounted for based on the equity method. Transitional provisions vary depending on how an interest is classified under IAS 31, effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

IFRS 12 Disclosure of Interest in Other Entities:

IFRS 12 requires extensive disclosure relating to an entity’s interest in subsidiaries, joint arrangements, associates and unconsolidated structure entities. Incorporation of disclosure is permitted, without early adoption of IFRS 12, IFRS 10, IFRS 11, IAS 27 (as amended 2011) and IAS 28 (as amended 2011), effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

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

IAS 27 (as amended 2011) Separate Financial Statements:

IAS 27 (2011) provides guidance on the accounting and disclosure requirements for subsidiaries, jointly controlled entities, and associates in separate, or unconsolidated, financial statements, effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

IAS 28 (as amended 2011) Investments in Associates:

The amended IAS 28 (2011) provides detailed guidance on the application of the equity method to associates, subsidiaries and joint ventures (previously excluded from this standard), effective January 1, 2013. Management does not expect a material impact to the financial statements as a result of adopting this standard.

### 2.6 Fiscal periods

The Company's 2012 fiscal period is divided in quarters as follows:

| | Period from January 2, 2012 to December 30, 2012 ("Fiscal 2012") | | Period from January 3, 2011 to January 1, 2012 ("Fiscal 2011") | |
|---|---|---|---|---|
| | Period End Date | # of Weeks | Period End Date | # of Weeks |
| Quarter 1 | April 1, 2012 | 13 | April 3, 2011 | 13 |
| Quarter 2 | July 1, 2012 | 13 | July 3, 2011 | 13 |
| Quarter 3 | September 30, 2012 | 13 | October 2, 2011 | 13 |
| Quarter 4 | December 30, 2012 | 13 | January 1, 2012 | 13 |
| Fiscal year | December 30, 2012 | 52 | January 1, 2012 | 52 |

## 3. ACCOUNTS RECEIVABLE

| | **July 1, 2012** | January 1, 2012 |
|---|---|---|
| Trade | $ 104,529 | $ 111,047 |
| Other | 4,161 | 4,803 |
| | $ 108,690 | $ 115,850 |

## 4. INVENTORIES

| | **July 1, 2012** | January 1, 2012 |
|---|---|---|
| Raw materials | $ 49,205 | $ 45,454 |
| Work in process | 37,722 | 46,340 |
| Finished goods | 6,836 | 1,697 |
| | $ 93,763 | $ 93,491 |

The cost of inventories recognized as expense and included in cost of sales during the 13-week period ended July 1, 2012 ("2012 Q2") and the 26-week period ended July 1, 2012 ("2012 YTD") amounted to $191,707 and $384,922 respectively (2011 Q2 and 2011 YTD: $190,174 and $364,323). During 2012 Q2 and 2012 YTD, the Company had a write-down of inventory to net realizable value recorded in cost of sales of $259, and $617, respectively and $924, and $1,033 for the 13-week period ended July 3, 2011 ("2011 Q2") and 26-week period ended July 3, 2011 ("2011 YTD"). As well, there was $192 of reversals of a previous write-down in inventory in 2012 Q2 (2011 Q2: $nil).

## 5. DEFERRED TAXES AND INCOME TAX EXPENSE

| | **July 1, 2012** | January 1, 2012 |
|---|---|---|
| Deferred tax assets: | | |
| Deferred tax asset to be recovered after more than 12 months | $ 29,926 | $ 33,416 |
| Deferred tax asset to be recovered within 12 months | 23,492 | 13,368 |
| | 53,418 | 46,784 |
| Deferred tax liabilities: | | |
| Deferred tax liability to be reversed after more than 12 months | (122,912) | (123,079) |
| Deferred tax liability to be reversed within 12 months | (9,742) | (6,235) |
| | (132,654) | (129,314) |
| **Deferred taxes (net)** | $ (79,236) | $ (82,530) |

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:

| | **July 1, 2012** | January 1, 2012 |
|---|---|---|
| As presented on statements of financial position: | | |
| Deferred tax assets | $ 49,066 | $ 36,558 |
| Deferred tax liabilities | (128,302) | (119,088) |
| **Deferred taxes (net)** | $ (79,236) | $ (82,530) |

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

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Beginning of period | $ (84,157) | $ (100,435) | $ (82,530) | $ (101,029) |
| Exchange differences | (463) | (391) | (204) | — |
| Tax recorded through net earnings | 7,011 | (1,844) | 6,896 | (1,641) |
| Tax recorded through other comprehensive loss | — | — | 48 | — |
| Tax recorded through equity | (1,627) | — | (3,446) | — |
| End of period | $ (79,236) | $ (102,670) | $ (79,236) | $ (102,670) |

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:

| **Deferred tax liabilities** | Property, Plant and Equipment | Goodwill and Intangibles | Other | **Total** |
|---|---|---|---|---|
| January 1, 2012 | $ (791) | $ (128,619) | $ 96 | $ (129,314) |
| Tax reversed (charged) through net earnings | 170 | 2,976 | (4,977) | (1,831) |
| Tax recovered through equity | — | — | (1,509) | (1,509) |
| **July 1, 2012** | $ (621) | $ (125,643) | $ (6,390) | $ (132,654) |

**5. DEFERRED TAXES AND INCOME TAX EXPENSE (Continued)**

| Deferred tax assets | Provisions | Pension | Deferred Financing costs | Other | Total |
|---|---|---|---|---|---|
| January 1, 2012 | $ 15,220 | $ 3,435 | $ 8,138 | $ 19,991 | $ 46,784 |
| Tax recovered (charged) through net earnings | (2,722) | 93 | 6,846 | 4,510 | 8,727 |
| Tax recovered through other comprehensive loss | — | 48 | — | — | 48 |
| Tax recovered through equity | — | — | (323) | (1,614) | (1,937) |
| Exchange differences | (73) | (18) | (40) | (73) | (204) |
| **July 1, 2012** | $ 12,425 | $ 3,558 | $ 14,621 | $ 22,814 | $ 53,418 |

Deferred income tax assets are recognized for income tax loss carry-forwards to the extent that the realization of the related tax benefit through future taxable profits is probable. The Company has an income tax loss carry-forward of $386 which will more likely than not be applied against future taxable income and therefore a related deferred tax asset has been recorded. The right to claim these losses expires as follows:

| | |
|---|---|
| 2013 to 2019 (includes U.S. federal tax losses that are restricted in application to $55 per year) | $ 386 |

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

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Earnings (loss) before income tax expense | $ 1,620 | $ (6,502) | $ 3,605 | $ (10,226) |
| Tax calculated using a 35% U.S. tax rate | 567 | (2,275) | 1,262 | (3,579) |
| Tax effect of: | | | | |
| Tax recorded through equity | (239) | — | (2,058) | — |
| Non-taxable income | — | 1,283 | — | — |
| Benefit of deductible share issue costs | — | (63) | — | (121) |
| Withholding and other taxes | 391 | 718 | 250 | 1,279 |
| Non-deductible expenses | 909 | 1,300 | 1,437 | 1,701 |
| Revision of tax estimates | (36) | — | (68) | — |
| Rate differential on income taxed at other than U.S. statutory rate | (1,627) | — | (2,305) | — |
| Foreign exchange impact | (1,397) | (385) | (677) | 3,901 |
| State taxes | (659) | 51 | (608) | 76 |
| Other | 107 | 188 | 41 | 197 |
| **Income tax (recovered) expense for the period** | $ (1,984) | $ 817 | $ (2,726) | $ 3,454 |

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Current income taxes (recovered) for the period | $ 5,027 | $ (3,226) | $ 4,170 | $ (386) |
| Deferred income taxes (recovered) for the period | (7,011) | 4,043 | (6,896) | 3,840 |
| **Income tax (recovered) expense for the period** | $ (1,984) | $ 817 | $ (2,726) | $ 3,454 |

**6. LONG-TERM DEBT**

| | Final Maturity | Face Value | Early Redemption Premium | Unamortized Transaction Costs | **Net Book Value July 1, 2012** | Net Book Value January 1, 2012 |
|---|---|---|---|---|---|---|
| Subordinated Notes included in the IDS issue (a) | 2020 | $ 30,757 | $ 1,538 | $ — | $ 32,295 | $ 30,547 |
| Separate Subordinated Notes (a) | 2020 | 27,019 | 1,350 | — | 28,369 | 26,948 |
| Term Credit Facility (b) | 2014 | 116,000 | — | (1,425) | 114,575 | 109,340 |
| Revolving Credit Facility (“Revolver”) (b) | 2014 | 21,000 | — | — | 21,000 | 9,000 |
| | | 194,776 | 2,888 | (1,425) | 196,239 | 175,835 |
| Less: current portion of long-term debt (c) | | 78,776 | 2,888 | — | 81,664 | 9,000 |
| | | $ 116,000 | $ — | $ (1,425) | $ 114,575 | $ 166,835 |

(a) NFI ULC has C$31,313 (January 1, 2012: C$31,313) aggregate principal amount of 14.0% unsecured subordinated notes included in the IDS issue (the "IDS Subordinated Notes") denominated in Canadian dollars held by third parties that mature August 2020 and C$27,508 (January 1, 2012: C$27,508) aggregate principal amount of separate 14.0% subordinated notes outstanding that were issued under the same terms and conditions as the subordinated notes included in the issuance of IDSs (“Separate Subordinated Notes”). The holders of the Separate Subordinated Notes and the IDS Subordinated Notes (together, the “Subordinated Notes”) vote together as a single class in proportion to the aggregate principal amount of Subordinated Notes they hold on all matters on which they are eligible to vote under the indenture.

On June 25, 2012, NFI ULC formally issued notice that it will redeem all of its C$58,821 aggregate principal amount of 14.0% Subordinated Notes, , held by third parties in accordance with the terms of the trust indenture governing the subordinated notes (the "Indenture"). These Subordinated Notes will be redeemed on August 20, 2012 at a total price of C$58.4812 per C$55.30 principal amount of Subordinated Notes, representing an early redemption price of C$58.065 per C$55.30 principal amount of Subordinated Notes (or 105% of principal), plus all accrued and unpaid interest to and including the redemption date. Notice of the redemption of the Subordinated Notes has been delivered to CDS Clearing and Depository Services Inc. in accordance with the terms of the Indenture.

A loss on exercise of redemption right of $5,530 was recognized during 2012 Q2 as a result of recording the present value of the August 20, 2012 redemption amount and the change in fair value of the embedded derivative call option included in the Subordinated Notes.

The redemption of the 14.0% Subordinated Notes will be financed with the net proceeds of NFI's recently completed public offering of Debentures (note 7). As the Subordinated Notes are denominated and redeemable in Canadian dollars, the Company converted the U.S. dollar proceeds from the Debentures offering into Canadian dollars on June 5, 2012.

On the redemption date, the IDSs will be automatically separated and holders of IDSs will receive (i) that number of Shares equal to the number of IDSs held immediately prior to redemption of the Subordinated Notes, and (ii) C$58.4812 per C$55.30 principal amount of Subordinated Notes, representing the redemption price, plus all accrued and unpaid interest to and including the redemption date.

Upon completion of the redemption of the Subordinated Notes, NFI ULC will apply to cease to be a reporting issuer under the securities laws of each province and territory of Canada. New Flyer will also apply to de-list the IDSs from the TSX and, following such de-listing, the Shares that form part of the IDSs will commence trading separately and continue to be listed (together with the current Shares of NFI) on the TSX under the trading symbol "NFI".

**6. LONG-TERM DEBT (Continued)**

(b) On June 25, 2012, the Company entered into a third amended and restated credit agreement (the "Credit Facility") with The Bank of Nova Scotia and Bank of Montreal, as co-lead arrangers and joint book runners, and a syndicate of leading Canadian and American financial institutions in the amount of $195.0 million and a $75.0 million accordion term loan feature. The Credit Facility matures on April 24, 2014 and consists of a $105.0 million term loan (the "Term Credit Facility"), which includes a $15.0 million delayed draw loan (of which $9.0 million was drawn at July 1, 2012) and a $75.0 million accordion term loan feature, under which $17.0 million was drawn at July 1, 2012. As well, there exists a $90.0 million revolver, which includes a $55.0 million letter of credit sub-facility (the "Revolver") (of which $21.0 million of direct borrowings and $13.4 million of outstanding letters of credits were drawn at July 1, 2012).

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. As at July 1, 2012, the Company was in compliance in all material respects with all applicable obligations under the Credit Facility.

The June 25, 2012 Credit Facility amendments adjusted certain of the financial covenants effective on the redemption of the Subordinated Notes. The covenant changes are intended to reflect the Company's new capital structure following the redemption of the Subordinated Notes.

(c) The net book value of the August 20, 2012 Subordinated Notes redemption amount of $60,664 and the $21,000 of Revolver that is outstanding at July 1, 2012 has been presented as current portion of long-term debt.

**7. CONVERTIBLE DEBENTURES**

On June 5, 2012, the Company completed a public offering, on a "bought deal" basis, of $65,000 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 Debentures will be convertible at the holder's option into common shares of the Company at a conversion price of $10.00 per Share ("Conversion Option"). The Debentures will not be redeemable prior to June 30, 2015. 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 Toronto Stock Exchange 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.

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 fair value of the Conversion Option, net of taxes, is classified as a separate component of shareholders' equity. Estimated transaction costs incurred for the issuance of the Debentures are $3,789. The unamortized transaction costs recorded against the Debenture liability will be accreted to nil through a periodic charge to accretion expense over the five-year term of the Debentures at the effective interest rate of the Debenture liability. The unamortized transaction costs at July 1, 2012 are $3,463 related to the liability component.

| | Debenture liability component | Equity component of Debenture | **Net Book Value July 1, 2012** | Net Book Value January 1, 2012 |
|---|---|---|---|---|
| Debentures | $ 59,412 | $ 5,588 | $ 65,000 | $ — |
| Transaction costs | (3,463) | (326) | (3,789) | — |
| Deferred taxes | — | (1,509) | (1,509) | — |
| Net book value | $ 55,949 | $ 3,753 | $ 59,702 | $ — |

## 8. SHARE CAPITAL

| Authorized | | | |
|---|---|---|---|
| Unlimited | Common Shares | | |
| Issued | | **July 1, 2012** | January 1, 2012 |
| 44,379,070 | Common Shares (January 1, 2012: 44,379,070) | $ 476,918 | $ 476,918 |

The dividends declared in 2012 Q2 and 2011 Q2 were $9,456 ($0.21 per Share) and $5,086 ($1.03 per Share) respectively. Dividends of $3,180 ($0.07 per Share) were declared after July 1, 2012 but prior to the Statements being authorized for issue. The Statements do not reflect this dividend payable.

## 9. EARNINGS PER SHARE

On September 30, 2011, shareholders approved the consolidation of the issued and outstanding Shares on the basis of one post-consolidation Share for every ten pre-consolidation Shares held. To reflect the 10:1 share consolidation under IAS 33 *Earnings Per Share*, a retrospective application is required in calculating the basic and diluted earnings per share using the weighted average number of shares outstanding.

a) 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 in issue 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. Weighted average number of Shares for 2012 Q2 and 2011 Q2 of 44,379,070 and 4,947,528, respectively and 2012 YTD and 2011 YTD of 44,379,070 and 4,947,528 respectively.

b) Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding assuming conversion of all dilutive potential ordinary shares using closing share price at the period end date. The Debentures are assumed to have been converted into Shares, and the net earnings are adjusted to eliminate the interest expense less the tax effect.

| | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Net earnings (loss) attributable to equity holders | $ 3,604 | $ (7,319) | $ 6,331 | $ (13,680) |
| Add: Interest expense on convertible debentures, net of tax | 301 | — | 301 | — |
| Net earnings (loss) used to determine diluted earnings per Share | 3,905 | (7,319) | 6,632 | (13,680) |
| Weighted average number of Shares in issue | 44,379,070 | 4,947,528 | 44,379,070 | 4,947,528 |
| Add: assumed conversion of convertible debentures | 10,526,316 | — | 10,526,316 | — |
| Weighted average number of Shares for diluted earnings per Share | 54,905,386 | 4,947,528 | 54,905,386 | 4,947,528 |
| **Net earnings (loss) per Share (basic)** | 0.08 | (1.48) | 0.14 | (2.77) |
| **Net earnings (loss) per Share (diluted)** | $ 0.07 | $ (1.48) | $ 0.12 | $ (2.77) |

## 10. SUPPLEMENTAL CASH FLOW INFORMATION

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

| Cash inflow (outflow) | **13-Weeks Ended July 1, 2012** | 13-Weeks Ended July 3, 2011 | **26-Weeks Ended July 1, 2012** | 26-Weeks Ended July 3, 2011 |
|---|---|---|---|---|
| Accounts receivable | $ (361) | $ 8,102 | $ 4,195 | $ (41,738) |
| Income taxes recoverable | 1,272 | (2,708) | — | (5,110) |
| Inventories | (1,211) | (11,492) | (272) | (34,217) |
| Prepaid expenses and deposits | 104 | 376 | 1,340 | 951 |
| Accounts payable and accrued liabilities | (10,691) | 12,415 | (7,511) | 57,936 |
| Income taxes payable | 760 | — | (4,204) | — |
| Deferred revenue | 357 | 10,601 | (306) | (13,557) |
| Provision for warranty costs | (3,312) | (4,085) | (6,511) | (4,401) |
| Other | (3,097) | (2,749) | 3,183 | (1,362) |
| | $ (16,179) | $ 10,460 | $ (10,086) | $ (41,498) |

## 11. EMPLOYEE FUTURE BENEFITS

***Defined benefit plan***

The Company recorded a net defined benefit pension expense of $438 and $2,677 (2011 - $457 and $913) for 2012 Q2 and 2012 YTD. No actuarial gain/losses were estimated for 2012 Q2.

***Defined contribution pension plans***

In the United States, the Company maintains two savings retirement plans (401(k) plans). In Canada, the Company maintains a defined contribution plan for salaried employees. The Company recorded a net defined contribution pension expense of $539 and $1,012 (2011 - $522 and $1,039) for 2012 Q2 and 2012 YTD.

Cash payments contributed by the Company during 2012 Q2 and 2012 YTD for its defined benefit and defined contribution pension plans amounted to $1,390 and $3,534 (2011 - $1,858 and $3,508), respectively.

## 12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

**(a) Financial Instruments**

The Company has made the following classifications:

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

**(b) 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.

**12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)**

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 (loss) and comprehensive income (loss) consistent with the underlying nature and purpose of the derivative instruments.

During 2012 Q2, the Company recorded a realized foreign exchange gain of $1,848 (2011: $479). This was comprised of a $703 gain on settlement of foreign exchange contracts and a $959 foreign currency gain on translation of Canadian dollar denominated operations.

At July 1, 2012, the Company has foreign exchange forward contracts that range in expiry dates from July to September 2012. The related liability of $66 (January 1, 2012: $145 asset) is recorded on the interim condensed consolidated statements of financial position as a current derivative financial instrument and the corresponding change in the fair value of the foreign exchange forward contracts has been recorded in the interim condensed consolidated statements of net earnings (loss) and comprehensive income (loss).

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 $90,000 out of the $116,000 drawn term loan. The interest rate swap fixes the interest rate at 1.90% plus the applicable interest margin until April 2014 (maturity date). The fair value of the interest rate swap liability at July 1, 2012 is $2,542 (January 1, 2012: $2,811) and the change in fair value has been recorded as finance costs for the reported period. The related liability has been recorded on the interim condensed consolidated statements of financial position as a derivative financial instruments liability.

An embedded derivative exists relating to the Company’s right to prepay the Subordinated Notes. As a result of the Company exercising its redemption right on June 25, 2012, the fair value of the embedded derivative asset at July 1, 2012 is $nil (January 1, 2012: $3,684).

**(c) 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 July 1, 2012, the Company had a cash balance of $67,195 (January 1, 2012 $10,133) and the $90,000 Revolver. The cash balance includes $61,211 of net cash generated from the issuance of Debentures which will be used to redeem the Subordinated Notes in August 2012. As at July 1, 2012, there was $21,000 of direct borrowings (January 1, 2012 $9,000) and $13,441 of outstanding letters of credits (January 1, 2012: $13,774) under the Revolver.

The Company’s principal sources of funds are cash generated from its operating activities and borrowing capacity remaining under the Credit Facility. Management believes that these funds will provide the Company 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.

**(d) 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 (loss) and comprehensive income (loss) 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 (loss) and comprehensive income (loss).

**12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)**

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

| | July 1, 2012 | January 1, 2012 |
|---|---|---|
| Current, including holdbacks | $ 105,220 | $ 110,563 |
| Past due amounts but not impaired | | |
| 1 – 60 days | 2,690 | 2,671 |
| Greater than 60 days | 837 | 2,665 |
| Less: Allowance for doubtful accounts | (57) | (49) |
| Total accounts receivables, net | $ 108,690 | $ 115,850 |

As at July 1, 2012, 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 a fixed charge coverage ratio, senior leverage ratio and total leverage ratio. Beginning August 20, 2012, the fixed charge coverage ratio will be replaced by an interest coverage ratio of not less than 3.00 and the total leverage ratio will be changed to less than 3.25 and will not include the Debentures. At July 1, 2012, the Company is in compliance with the new and revised ratios.

As at July 1, 2012; the Company is in compliance with the financial covenants in the Credit Facility. The results of the financial covenants tests as of such date are as follows:

| | July 1, 2012 | January 1, 2012 |
|---|---|---|
| Senior Leverage Ratio (must be less than 2.50) | 1.03 | 1.43 |
| Total Leverage Ratio (must be less than 3.75) * | 1.84 | 2.15 |
| Fixed Charge Coverage Ratio (must be greater than 1.10) | 1.63 | 1.26 |

* Decreased from 4.75 effective June 25, 2012 as per Amended Credit Facility

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.

**13. 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 heavy-duty transit buses for public transportation. The Aftermarket Operations segment derives its revenue from the provision of service parts and support related to heavy-duty 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 foreign exchange gains or losses, losses or gains on disposition of property, plant and equipment, depreciation of property, plant and equipment, amortization of intangible assets, interest expense and income, fair value adjustment to embedded derivatives, accretion in carrying value of long-term debt and gains and losses on the Company's interest rate swap. Corporate overhead costs are allocated fully to the Bus Operations segment. The Bus Operations segment has recorded vendor rebates of $1,525 (2011 Q2: $1,902), which have been recognized into earnings during 2012 YTD, but for which the full requirements for entitlement to these rebates have not yet been met.

**13. SEGMENT INFORMATION (Continued)**

The unallocated total assets of the Company primarily include cash, intangible assets, embedded derivative instruments, 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 Ended July 1, 2012** | | | |
|---|---|---|---|---|
| | **Bus Operations** | **Aftermarket Operations** | **Unallocated** | **Total** |
| Revenue from external customers | $ 197,369 | $ 29,611 | $ — | $ 226,980 |
| Operating costs and expenses | 187,707 | 24,536 | — | 212,243 |
| Earnings (loss) before income tax expense | 9,662 | 5,075 | (13,117) | 1,620 |
| Total assets | 373,971 | 100,231 | 450,592 | 924,794 |
| Addition of property, plant and equipment | 2,057 | — | — | 2,057 |
| Addition of intangible assets | — | 134 | — | 134 |
| Goodwill | 148,483 | 53,685 | — | 202,168 |

| | 13-Weeks Ended July 3, 2011 | | | |
|---|---|---|---|---|
| | **Bus Operations** | **Aftermarket Operations** | **Unallocated** | **Total** |
| Revenue from external customers | $ 194,723 | $ 31,130 | $ — | $ 225,853 |
| Operating costs and expenses | 183,792 | 23,775 | — | 207,567 |
| Earnings (loss) before income tax expense | 10,931 | 7,355 | (24,788) | (6,502) |
| Total assets | 368,028 | 98,679 | 403,962 | 870,669 |
| Addition of property, plant and equipment | 971 | 25 | — | 996 |
| Goodwill | 148,483 | 53,685 | — | 202,168 |

| | **26-Weeks Ended July 1, 2012** | | | |
|---|---|---|---|---|
| | **Bus Operations** | **Aftermarket Operations** | **Unallocated** | **Total** |
| Revenue from external customers | $ 393,602 | $ 61,022 | $ — | $ 454,624 |
| Operating costs and expenses | 375,467 | 50,202 | — | 425,669 |
| Earnings (loss) before income tax expense | 18,135 | 10,820 | (25,350) | 3,605 |
| Total assets | 373,971 | 100,231 | 450,592 | 924,794 |
| Addition of property, plant and equipment | 5,693 | 24 | — | 5,717 |
| Addition of intangible assets | — | 134 | — | 134 |
| Goodwill | 148,483 | 53,685 | — | 202,168 |

**13. SEGMENT INFORMATION (Continued)**

| | 26-Weeks Ended July 3, 2011 | | | |
|---|---|---|---|---|
| | **Bus Operations** | **Aftermarket Operations** | **Unallocated** | **Total** |
| Revenue from external customers | $ 382,181 | $ 58,016 | $ — | $ 440,197 |
| Operating costs and expenses | 356,599 | 45,038 | — | 401,637 |
| Earnings (loss) before income tax expense | 25,582 | 12,978 | (48,786) | (10,226) |
| Total assets | 368,028 | 98,679 | 403,962 | 870,669 |
| Addition of property, plant and equipment | 1,918 | 101 | — | 2,019 |
| Goodwill | 148,483 | 53,685 | — | 202,168 |

**14. 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 July 1, 2012 range from July 2012 to July 2013.

At July 1, 2012, outstanding surety bonds guaranteed by the Company totaled $44,441 (January 1, 2012: $32,042). 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 $90,000 Revolver. As at July 1, 2012, letters of credit totaling $13,441 (January 1, 2012: $13,774) remain outstanding under the letter of credit facility.

As at July 1, 2012, 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.

**15. PROVISION FOR WARRANTY COSTS**

Extended warranties for major subsystems such as engines, transmissions, axles and air conditioning are normally purchased for the customer from the manufacturer. The Company will also provide other 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.

Under the fleet defect provisions included in some bus purchase contracts, the Company is required to repair the entire fleet of buses delivered under the contract if the same defect occurs in more than a specified percentage of the fleet (typically 10% to 20%) within a stated period following delivery of the bus (typically 12 months following delivery of the bus). The Company also frequently provides a parts guarantee in its bus purchase contracts, under which the Company guarantees that bus parts will be available to the customer for a certain period of time, usually 15 years following delivery of the bus. 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 builds an estimate of these costs into each of its contracts based on the Company's historical experience and technical expectations.

**15. PROVISION FOR WARRANTY COSTS (Continued)**

The movement in the provision for warranty costs during the period is as follows:

| | | Total |
|---|---|---|
| January 1, 2012 | $ | 32,808 |
| Additions | | 8,317 |
| Amounts used/realized | | (14,803) |
| Unwinding of discount and effect of changes in the discount rate | | 96 |
| Exchange differences | | (121) |
| **July 1, 2012** | $ | 26,297 |