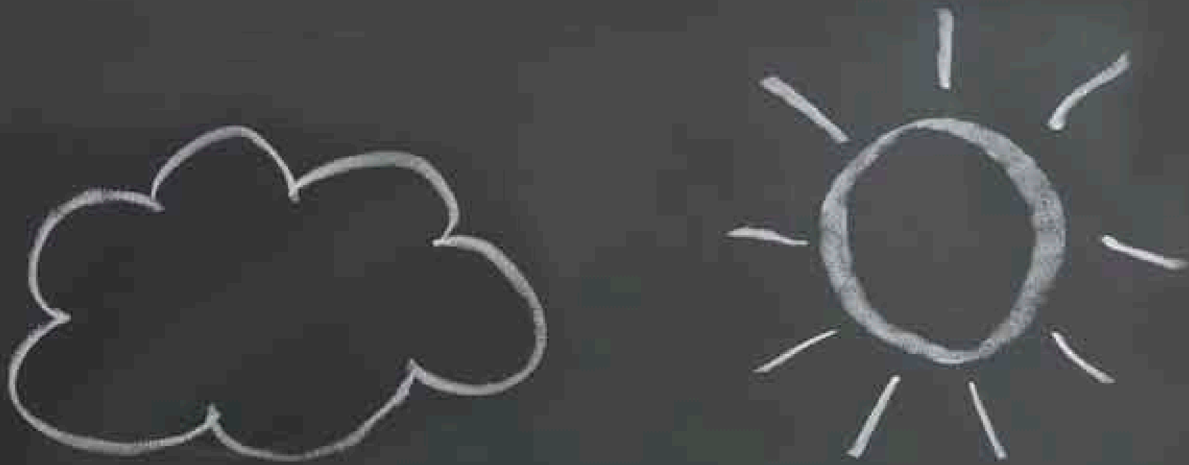
Hammond Power Solutions Inc.

# Resilience.

Tough times don't last,
tough companies do.

2017 Annual Report



# Our Vision

To be a leading global supplier of transformers and magnetics within our chosen markets.

## Our Mission

We are a growing and profitable global supplier of transformers and related magnetic products dedicated to satisfying the collective needs of our shareholders, customers, suppliers, employees and community.

## Our Values

We value the **safety and well-being** of all

We expect **honesty, integrity and ethical behaviour**

We embrace **diversity** by nurturing an inclusive environment and treating everyone with dignity and respect

We promote **innovation** and a relentless pursuit of continuous improvement through teamwork

We believe in **a collaborative approach** to social and environmental sustainability

# What you need to know within this report



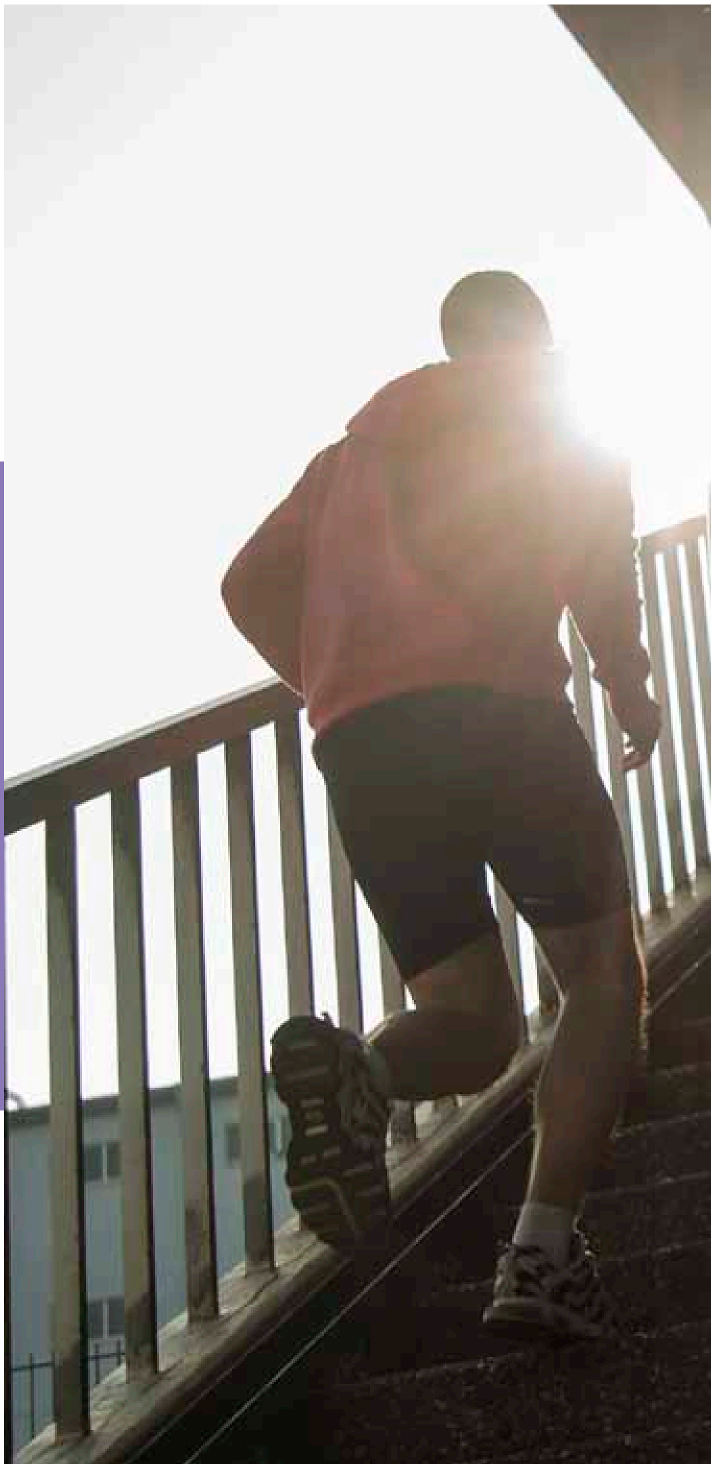
Coming together is a beginning; keeping together is progress; working together is success.

*– Henry Ford*

Against a backdrop of North American electrical industry growth of 5%, Hammond Power Solutions Inc.' sales increase of 10% demonstrates our ability to deliver gains in key customers sales and market segments.

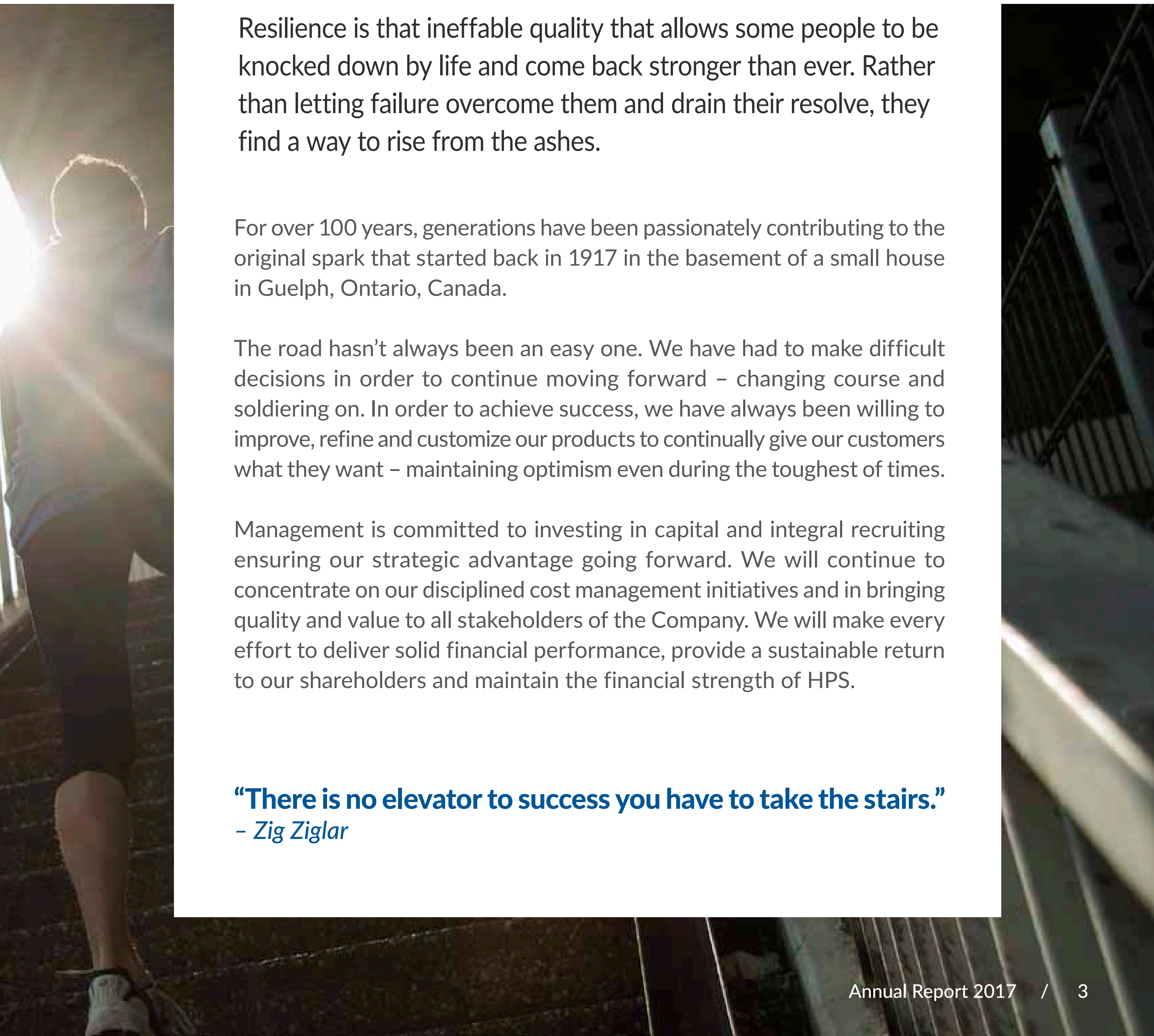
+10%

sales increase



2017

# Our success lies in our resilience, dedication and commitment.



Resilience is that ineffable quality that allows some people to be knocked down by life and come back stronger than ever. Rather than letting failure overcome them and drain their resolve, they find a way to rise from the ashes.

For over 100 years, generations have been passionately contributing to the original spark that started back in 1917 in the basement of a small house in Guelph, Ontario, Canada.

The road hasn't always been an easy one. We have had to make difficult decisions in order to continue moving forward – changing course and soldiering on. In order to achieve success, we have always been willing to improve, refine and customize our products to continually give our customers what they want – maintaining optimism even during the toughest of times.

Management is committed to investing in capital and integral recruiting ensuring our strategic advantage going forward. We will continue to concentrate on our disciplined cost management initiatives and in bringing quality and value to all stakeholders of the Company. We will make every effort to deliver solid financial performance, provide a sustainable return to our shareholders and maintain the financial strength of HPS.

**"There is no elevator to success you have to take the stairs."**
*– Zig Ziglar*

# To our shareholders,

We are pleased to report a very successful year for Hammond Power Solutions Inc. ("HPS") with growth in both sales and profits.

2017 was notably an important year for HPS as we celebrated our 100th year in business and surpassed $300 million in annual sales. We celebrated a year of positive activities and are looking forward to continued growth in 2018.

North America contributed the most to our improved financial performance with impressive sales growth in India of 38%.

Following a prolonged period of slow industrial and export activity, the North American economy along with the global economy began a synchronized expansion, which we have not seen in 10 years. Sales in the United States grew by 12% compared to 2016 and by 9% in Canada. Gross margins in both countries also improved; driven mostly by product redesigns and manufacturing cost reductions.

The growth of the Indian economy is now among the highest in the world and our business is growing at a similar pace. The Indian economy is a very competitive market with over 500 small companies building transformers, however the opportunities and the magnitude of growth in the years ahead are unparalleled.

Europe was the only area where results lagged prompting a major restructuring of our Italian operations to reduce our costs. Consequently, after five years of extremely difficult economic and market conditions as well as an ambitious effort to turn business around, the decision was made to sell the vacuum pressure impregnated ("VPI") transformer business and manufacturing facility in Meledo, Italy. The remaining cast coil production was consolidated with our Marnate, Italy facility. Although a set back in the short term, we are confident that our European business will turn around in 2018.

It is hard to believe that this small company that began as O.S. Hammond & Son in the basement of the family homestead in 1917 by my Grandfather would have grown into one of the largest dry transformer companies in the world with 1,400 employees and 11 plants in Canada, the United States, Mexico, Italy and India.

HPS is still a family business in many ways. The preservation of our original company values with regards to the well-being and involvement of our employees, the timeless importance of product quality, and the focus on serving the needs of our customers, are all intrinsic parts of how we do business today.

At a time when the world economy has indeed become global in nature and breadth, there are growing political pressures to erect trade barriers to protect local interests. Industry consolidation is creating great change and disruption, even where long term relationships existed. Future competition is just as likely to come from Korea or China as it might from Illinois or Tennessee.

Digital technology is changing how people source and buy products and as Baby Boomers retire we are in the process of the biggest generational turnover of employees since the 1970's. All of these pose big challenges for all companies today, but they are also opportunities for companies like HPS with the vision, the capabilities, the strategies, the flexibility and the resilience to adapt and succeed.

I am certain that the Hammond Power Solutions of 20 years from now will look just as dramatically different as we look today compared to the company of 100 years ago. The global economy and trade, the impact of technology and how business is done are all changing faster than ever before. It is the resilience of the Company that has allowed us to compete for over 100 years and it is that same resiliency that will keep us going in the future.

I am confident that the strong foundation that we have worked hard to improve upon over the last 17 years as Hammond Power Solutions, along with the existing talent across the organization and the new talent we will be adding in key positions as some of us retire, will help build this Company in different and meaningful ways going into the future.

We have a lot to be proud of but we also have a lot yet to accomplish – the best is yet to come. •

William G. Hammond
CHAIRMAN OF THE BOARD & CHIEF EXECUTIVE OFFICER
*Grandson of founder Oliver Hammond*

We learn from our set backs as well as from our successes and use that knowledge to move forward and grow.

We are proud to say that we are able to adapt and respond to internal or external changes — including opportunities, demands, disruptions or threats — and continue our operations with limited impact to our business.

The best is yet to come.

# We are very proud of our performance in 2017, which we attribute in part to the dedication and hard work of our employees, as well as the broad diversification of our geographical coverage, markets, channels and products.

## Sales Growth Opportunities

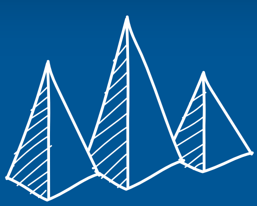
Our greatest opportunities for growth in the decade ahead will come from expanding our geographical coverage in selective markets outside of Canada and the U.S. as well as through our cast and energy efficient product offering in North America. Liquid-filled transformers, the dominant transformer technology in India will open up new business opportunities for HPS as Indian electrical codes change. Also, our geographical and market coverage of this rapidly growing country has increased our sales in sectors such as solar, commercial and industrial/ construction, drive systems, power generation and transformer servicing.

HPS' increased global footprint has become a gateway to new customers and markets as well as new technologies.

## New Product Development

The U.S. Department of Energy regulations and the upcoming Canadian energy efficiency standard changes (NRCan) have created opportunities for sales growth and ensure customer needs and regulations are being met. These regulation changes have resulted in new product development and manufacturing techniques. We have recently expanded our cast transformer capabilities in India utilizing the design and manufacturing capabilities of our European operation. This will open up new business opportunities for HPS as the installation of oil transformers in certain applications are limited for safety and environmental reasons. Low Indian labour costs could be to our advantage in the building of products for the North American and European markets.

| Increase In Sales | Increase in Net Earnings | Increase in EBITDA (adjusted) | Increase in Sales Growth in India |
|---|---|---|---|
| 10% | 241% | 32% | 38% |



## Rightsizing

In support of improving the Company's cost competitiveness and profit enhancement, HPS executed several strategic cost reduction activities during the year. The Company' restructuring of its North American administration costs and reorganization of its Italian operations through the reduction of excess capacity and workforce costs, positions the Company for improved financial performance.

## Enterprise Resource Planning System

The company's ERP system has enhanced the quality, timeliness and availability of information as well as improved efficiency by stream-lining processes. This system has been deployed in the majority of North American facilities and implementation began at our Indian operation during 2017. This enterprise resource planning system will allow for improved analysis and reporting and is one step closer to providing one global platform and a consistent source of information and data for improved planning and control.

# Management is committed to investing in capital and integral recruiting ensuring our strategic advantage going forward in 2018.

**Quality and Value**

We will continue to concentrate on our disciplined cost management initiatives and in bringing quality and value to all stakeholders of the Company.

**Financial Performance**

We will make every effort to delivery solid financial performance, provide a sustainable return to our shareholders and maintain the financial strength of HPS.

**Future Focus**

The company continues to be focused on escalation of market share, improved sales growth from new product development, geographic diversification, productivity gains, cost reduction and capacity flexibility.

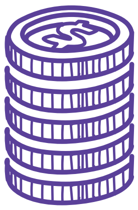
Solid financial metrics
Expand cast transformer line capabilities
Expand geographical coverage
Build the broadest and best distribution network across North America
Growing brand recognition
Engaged and innovative employees

- Broad product offering
- Product development
- Bringing value to all stakeholders of the Company

- Investing in capital and its employees
- Disciplined cost management initiatives
- Cash flow generation

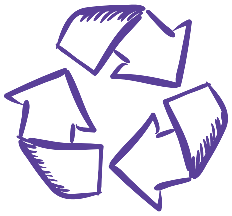
- Sales development
- Identifying and pursuing additional sales opportunities with both existing as well as new customers
- Product development
- Capital expansion

## HPS is strategically positioned to meet the evolving needs of our traditional markets as well as participating in a growing number of emerging sectors.

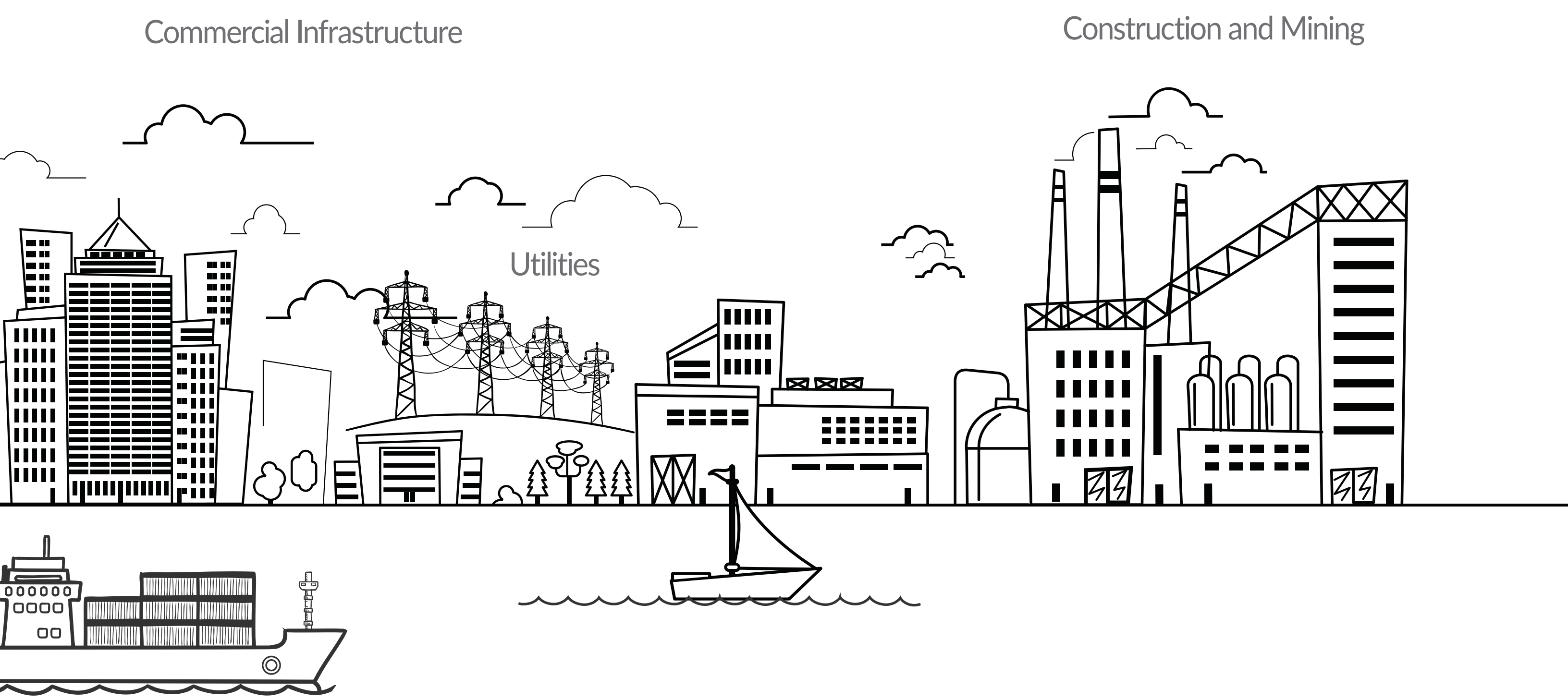


The Company's manufacturing facilities continue to be enhanced through our strategic commitment to invest in key talent, capital and product development.

Expansion in both India and Italy broadened their product offerings. These acquisitions provided HPS with cast resin technology, which introduced new customers and markets.



Our past requirement to comply with the U.S. Department of Energy regulations and the upcoming Canadian efficiency standard changes (NRCan) has created opportunities for sales growth and ensures customer needs and regulations are being met. These regulation changes have resulted in new product development and manufacturing techniques.




## A satisfied customer is the best business strategy of all.

*– Michael LeBoeuf*

# A review of operations

2017 has been a very positive year for Hammond Power Solutions. Not only did we experience the strongest recovery in our business since 2012, and we also celebrated the very special occasion of our 100th anniversary we also crossed the $300 million sales milestone.

We believe that delivering shareholder value means managing not only for short term performance but also for the long term health of our Company.

2017 has been a very positive year for Hammond Power Solutions. Not only did we experience the strongest recovery in our business since 2012, we also celebrated the very special occasion of our 100th anniversary and we also crossed the $300 million sales milestone. In many ways, we believe that these two situations are related. With over 70 years of experience designing and building transformers, HPS has developed a range of capabilities that are relatively unique compared to our North American competitors.

These capabilities have been vital to our Company through the tough economic times of this past decade. They have also put us in a very strong position to take advantage of the growth opportunities that are finally beginning to sprout in various geographies and markets over the last year.

For a variety of different reasons, the North American economy seemed to come alive after the distraction of the the U.S. Presidential election. The fundamental North American economy has been strengthening for several years, as indicated by strong consumer spending and falling unemployment. After almost five years of weak activity and ongoing uncertainty, industrial markets ignited in both Canada and the U.S. An important element to this was the synchronized resurgence in the global economy, spurred on by strong GDP growth in China, India, Russia and Europe. This has increased the consumption and prices of raw materials and other commodities which benefits Canada and a number of markets that HPS serves.

Exports of electrical equipment and machinery are expanding again due to this global growth as well as the weaker U.S. dollar. This new demand, coupled with the new U.S. corporate tax laws is resulting in more investment in manufacturing equipment and capacity than we have seen in years. This is reflected in the data showing that U.S. manufacturing capacity utilization has reached the highest levels since 2009. In addition to all of this, private non-residential construction is strengthening in North America particularly in sectors such as office, commercial, educational, health care and transportation construction – all contributing positively to our strong rebound in sales and profits in 2017.

In addition to the aforementioned, there are other factors that have also accelerated our growth over the last year – some of which have taken years to put in place: HPS has developed the broadest range of custom and standard dry transformer capabilities of any comparable company in North America; We have an employee culture that is very passionate about the transformer business and serving our customers' needs; Our six manufacturing operations in Canada, the U.S. and Mexico also give us greater flexibility in terms of cost and capacity, than any of our competitors; We have a strong focus on meeting the needs of our customers, particularly in terms of lead-times and on-time delivery performance. These capabilities are enhanced by the seven regional warehouses that we have across North America which carry large quantities of standard products.

Many people may assume that product quality should be a given when it comes to selecting a transformer supplier. The HPS brand is built around product quality as well as reliability. That reliability can be counted on not only by our customers but also our customer's customers. All of this has enabled HPS to build the broadest and best network of distributors across North America. Now that the economy is growing again, HPS is better positioned than ever before to increase our market share and grow our sales as the dominant dry transformer brand in North America.

Market diversity is also helping HPS grow at a faster rate than many other North American competitors. Our product capabilities, brand recognition and multiple channels to market have allowed us to be a major player in the mining, oil and gas, drive systems, public infrastructure, machine tool and other niche sectors. We are also using these same capabilities to grow our market share in the commercial construction, power quality and alternative energy markets. Market diversity has helped us hold our own over the last five years when many of our largest and most profitable markets were suffering through the global economic slowdown. As the overall economy continues to improve this year and next, our broad market diversity is expected to fuel even greater organic growth as presumably all sectors will benefit from this late cycle economic expansion.

In order to enlarge our geographical coverage out of North America, we are also working to expand our presence and sales in Mexico, the Caribbean, Central America and selective countries in South America. These markets will eventually be served out of our Monterrey operations where we have two plants and a Spanish-speaking work force. It is part of our corporate vision to be more of a global supplier going forward.

Another important cornerstone of this global strategy has been the growth of our Indian business. The vast majority of the products we build in India are liquid-filled transformers, which is the dominant transformer technology in this country.

Over the last year we have finished the buyout of our minority shareholders and completed a transformation of our management team with the addition of key talent in engineering, manufacturing and sales. We have expanded our geographical and market coverage of this rapidly growing country that has increased our sales in sectors such as solar, commercial and industrial/construction, drive systems, power generation and transformer servicing.

In 2017 we also initiated a number of projects to improve our operations including the reorganization of our plants to improve flow and efficiency, upgrade our test capabilities, as well as install the first Enterprise Resource Planning System ("ERP") system in our Indian operation. Over the last two years we have increased our sales by over 25% and believe that with the right strategies, we can continue strong double-digit growth for years to come.

We have recently expanded our cast transformer capabilities in India utilizing the design and manufacturing capabilities of our European operation. This will open up new business opportunities for HPS as Indian electrical codes change and the installation of oil transformers in certain applications are limited for safety and environmental reasons. Low Indian labour costs could be to our advantage in the building of products for the North American and European markets.

Europe was our first destination as part of our strategy to expand outside of North America. Our primary objective was to acquire a company with experience and technology in the cast transformer business – a transformer technology we would utilize in North America and India.

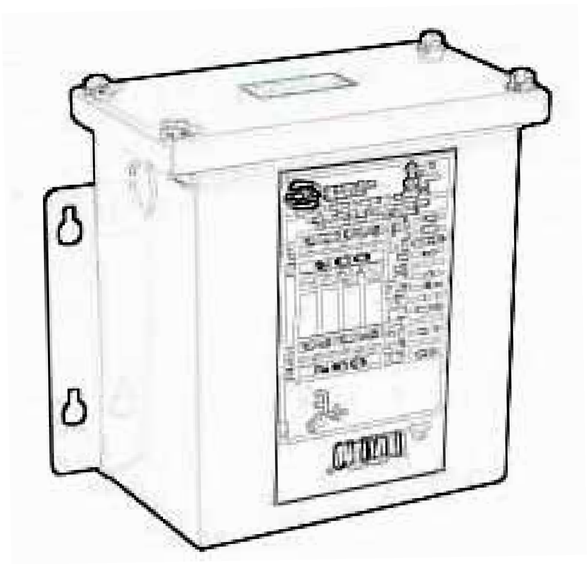
The company we acquired in Italy was manufacturing VPI transformers for solar power generation, a significant market in Europe at that time. What caught everyone off guard was the collapse of the solar market when Europe suffered its own financial crisis in 2012, causing countries like Germany, Italy and Spain to significantly reduce government subsidies for alternative energy companies. Investment in solar generation dropped by 50% overnight, which, had a cascading effect on all products sold into this market including transformers.

The economic slowdown spread across all of Europe and all markets, creating very tough and competitive conditions in the electrical industry. We downsized our operations while we continued to maintain production in two plants. Our challenges deepened when Russia, our second largest market, fell into a recession when world oil prices collapsed in late 2014, brought on by OPEC price cuts as well as a trade embargo due to their invasion of the Ukraine. The Russian economy has just begun to recover in 2017 along with the European economy after four challenging years. Unfortunately however, the VPI market never really recovered during this time and was made even worse by growing lower cost competition from Turkey, Eastern Europe and China.

Given all of these challenges, we finally decided in 2017 to take significant steps to restructure our European operations, reduce our manufacturing costs, as well as upgrade our talent rebuilding our business going forward. In Quarter 4, we sold off one of our Italian plants and the VPI business associated with that location. We then consolidated all of our cast transformer business in the remaining plant located outside of Milan, Italy. All of this resulted in restructuring costs associated with employee layoffs, production relocation and a variety of other statutory and operational costs. At the same time, we recruited a new European Sales Manager based in Germany as well as a new Director of International Operations who will be based in Italy, to improve our focus on the European market. We experienced some morale issues and disgruntled employees during this time – a common side effect from reorganization which impacted our final four months of the year more than expected leading to a slower start than desirable in 2018. These aggressive steps as well as the new management talent will lead in the longer term to a stronger, growing and more focused business in Europe, which is still the third largest market in the world following the U.S. and China.

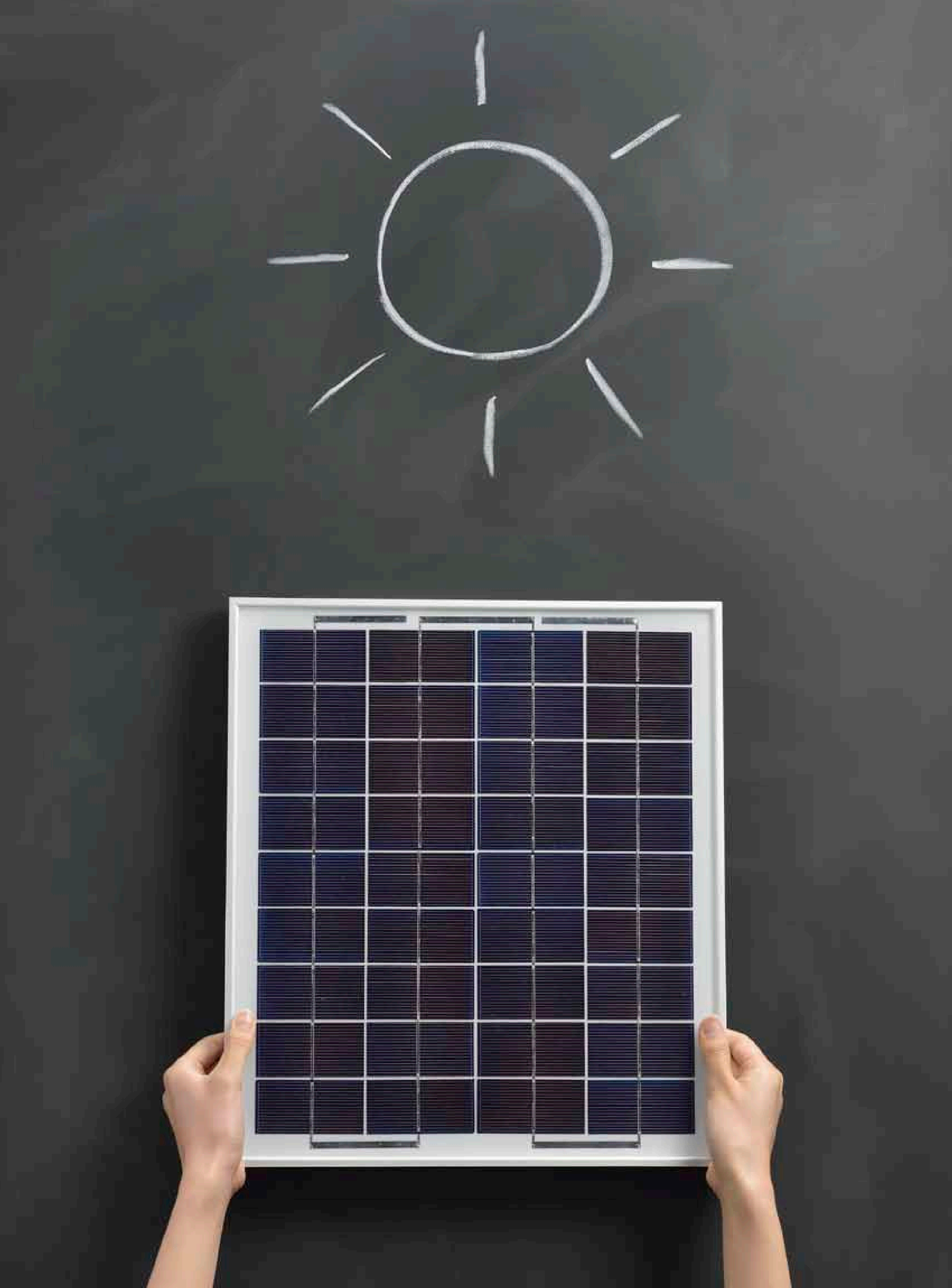
This restructuring is part of our larger vision to become a more global player going forward. Currently the dominant player in Canada, our business will fluctuate with the Canadian economy. We still have a number of years of market share growth ahead of us in the U.S. At some point in the next five years however our organic growth rate will naturally slow as our market share reaches a level where market and competitive pressures will limit our growth.

We have expanded our product capabilities in the



Transformers are critical components in solar energy production and distribution as solar power applications experience steady state loading while its converting power. Then, when the sun is out, there is a dampened reaction process and more constant loading on the transformer.

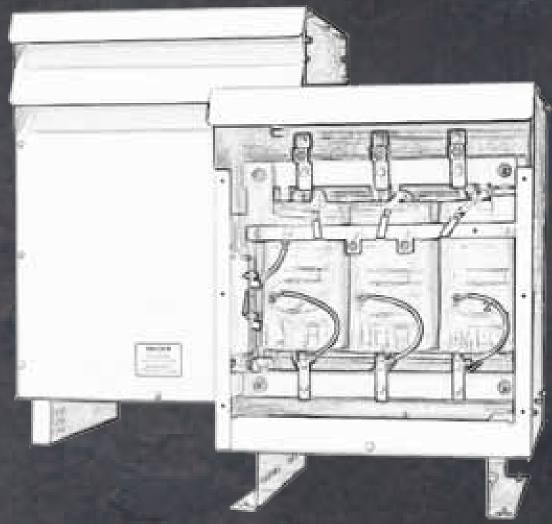
Growing demand and continuing industry consolidation keeps the industry future bright as renewable energy is becoming increasingly cost competitive. Countries world-wide are relying on alternative energy for generating electricity.



Distribution transformers step higher voltage levels on the utility grid down to lower voltage levels that power lights, equipment and other systems used in commercial, institutional and industrial buildings.

The HPS Sentinel transformers supply the power for elevators, lighting, HVAC, security and all other power loads used within commercial and office buildings.

North American retail, commercial and industrial electricity demand continues to grow along with the number of capital projects in support of infrastructure, hydro generation and distribution.



Typical Applications include:

- Commercial Buildings
- Institutional Buildings
- Industrial Buildings

dry and cast power transformer range, which is driving new growth for us in the commercial and industrial construction markets. We are also expanding our offering of power quality products which should generate modest growth in the years ahead.

We believe that the biggest opportunities for growth in the decade ahead will come from expanding our geographical coverage in selective markets outside of Canada and the U.S. – this being the reason why we acquired transformer companies in Europe and in India. This is also why we are in the early stages of expanding our presence in Mexico, the Caribbean, Central America and parts of South America. The challenges and risks are indeed greater, as we have discovered in these developing countries, but the potential growth rates as countries like Mexico and India expand and modernize their electrical systems and infrastructure are immense.

We are working diligently to improve the flexibility and cost effectiveness of our North American operations. After four years of slow economic growth in Canada and the U.S., which saw some large markets decline into negative territory, we redoubled our focus on reducing our cost structures.

For the first time since the recession of 2009 we downsized our salaried employee group in early 2017. This was part of a larger program that began in 2016 to reduce spending across the organization. Even as sales started to grow again in 2017, we held the line in adding shop floor employees as well as non-critical salaried positions. Our multiple manufacturing facilities in Canada, the U.S. and Mexico give us greater flexibility to move orders around without adding more people and more capacity.

Cost reductions and material savings through product redesigns have contributed to our ability to hold on to our margins in what remains a very competitive transformer market. We will continue to maintain this focus on controlling our costs and reducing them where we can without hurting our service levels and responsiveness as our business continues to grow.

As we look for ways to cut costs, hold back on hiring more resources and keep manufacturing capacity as is, we are working hard to maintain and even improve upon, the servicing of our customers by putting considerable attention and effort into improving our service levels.

Our goal is to consistently provide superior lead-times and on-time delivery to our Original Equipment Manufacturers ("OEM") and distributors. For standard transformers, we have accomplished this through our network of seven warehouses located coast-to-coast in Canada and the U.S., carrying a wide range of our most popular products.

For custom products, we monitor incoming orders and sales forecasts weekly, move production to our multiple manufacturing locations based on their loads, as well as work with our employees to flex their hours depending on the levels of business and critical delivery dates. We could not accomplish this if we did not have the support of our many key suppliers. All of this has become even more challenging as our markets have changed over the last five years along with the volatility and uncertainty of the economy in recent times. Quality and service excellence is a cornerstone of our brand and

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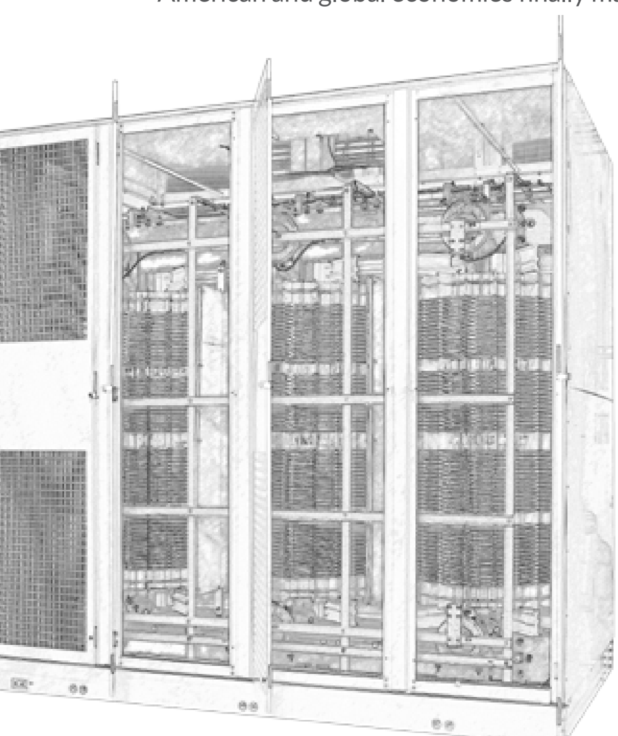
part of our strategy to grow our business. We continue to place emphasis on improving our performance and consistency with new projects such as the automation of our engineering processes. This is a complicated and multi-year project given the large number of our designs, but in the end it will further reduce our internal processing time in terms of quotations and engineering, improve our flexibility and reduce our costs further through product standardization.

We could never accomplish any of this without the engagement, innovation and hard work of our employees. Since the establishment of this Company 100 years ago as O.S. Hammond and Son, our employees have always been valued as our most important asset. It has become more challenging to balance the costs of fair compensation and benefits, employee training programs, minimize the negative effects of layoffs and more, against the ever escalating pressure to reduce costs and improve profitability in this globally competitive environment. We will continue to work hard to find a balance as we firmly believe that our employee culture along with our passion for the transformer business at all levels in this organization are the critical ingredients to the HPS brand and to our success – in the past, in these tough times that we have come through and in the future years to come.

2017 turned out to be a much better year than expected. The long awaited recovery of the North American and global economies finally materialized after years of slow and even declining growth. Recent tax changes in the U.S. as well as a synchronized expansion of the global economy with its positive impact on the consumption of resources and on the exports of manufactured products will drive even higher growth rates in 2018. Such growth will not match the incredible surge in business that the world enjoyed before the 2008 recession but the current business momentum is the best that HPS has seen in 10 years and we intend to ride it until the end of this economic cycle.

As many of you know, this is the longest period of recovery between recessions in recent history, even if this growth has been slight and uneven in many markets. This recovery will come to an end possibly brought on by rising interest rates, slowing consumer spending, or some potentially serious geopolitical event. We believe that HPS has at least two positive years of momentum ahead of us due to our diversity in geography, markets, channels and products.

Expanding our global footprint in India, Europe and Latin America is expected to give us additional lift in the coming years. Nonetheless while working hard at growing our sales and profits we will continue the focus on controlling our costs and reducing our bank debt to be ready and in a sound state when the next economic slowdown does come along. We believe that delivering shareholder value means managing not only for short term performance but also for the long term health of our Company.



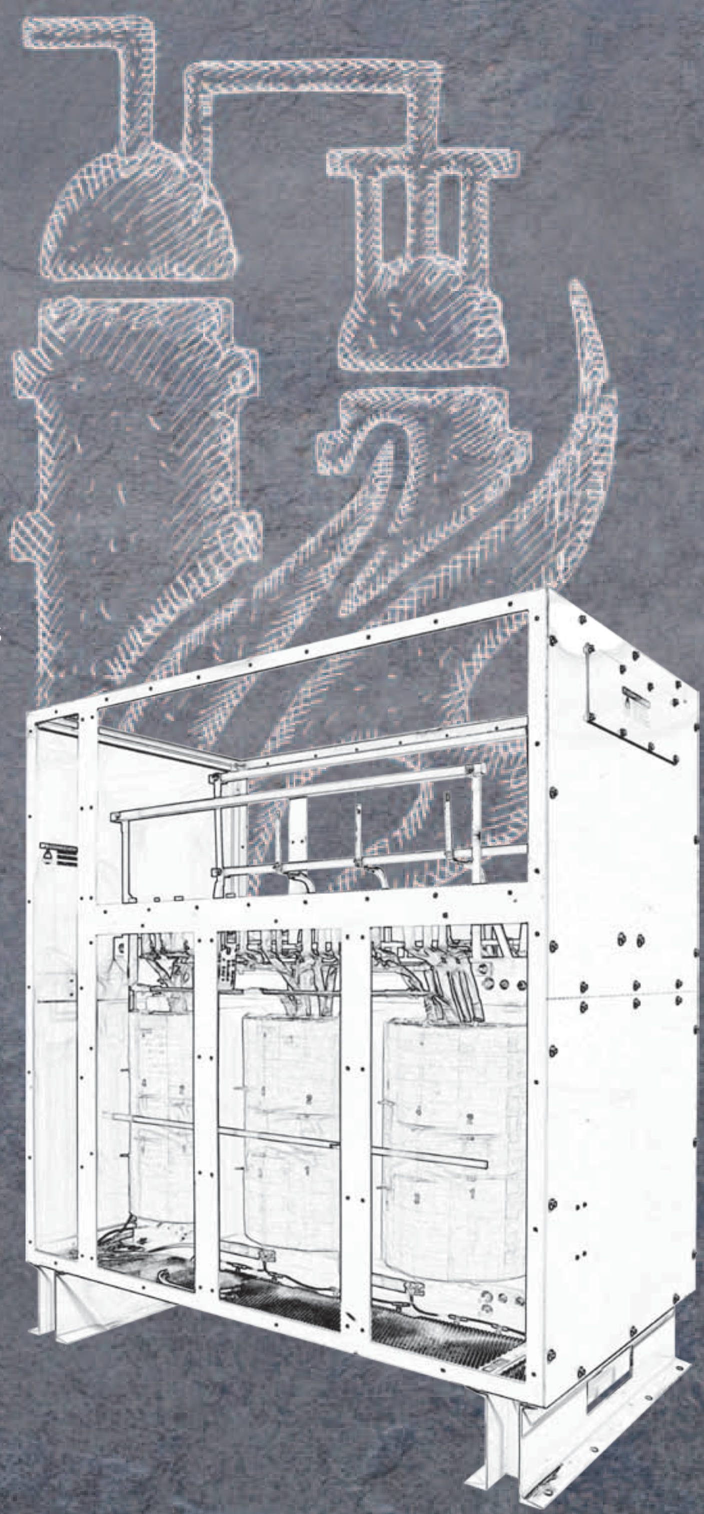
HPS Dry-Type Power Transformers (medium voltage) are regarded for their high level of quality and service reliability that has become synonymous with HPS transformer products.

These units can be offered for a variety of environmental conditions and are built to meet the most onerous duty requirements. In addition to conventional indoor applications, our dry units can be located outdoors, on drilling platforms, in network vaults and in every location where airborne contaminants pose a risk to electrical equipment.

Encapsulated transformers are used in installations where safety is your priority, efficiency is a concern and the environment, location and application are key.

HPS Titan® series has been designed to operate in harsh environments/hazardous locations where dangerous gases, liquids and dust could lead to serious consequences.

HPS shovel duty transformers are part of a new wave of power regulation that ensures uninterrupted operation while improving dynamic machine performance.

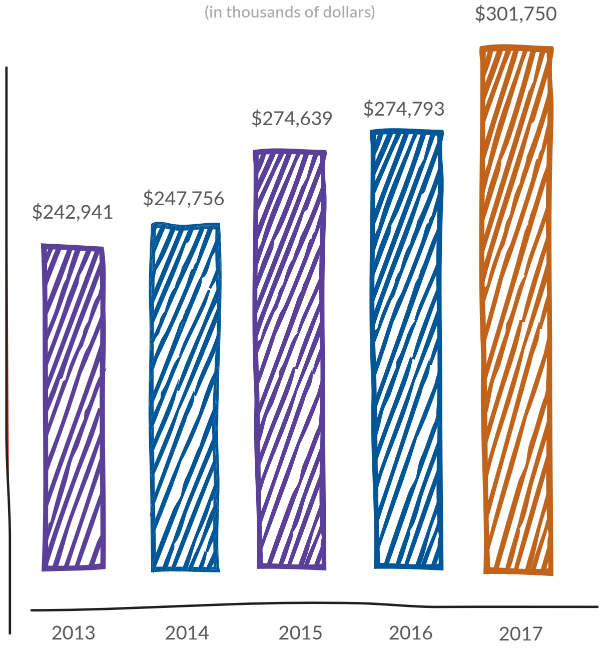


Typical Applications include:

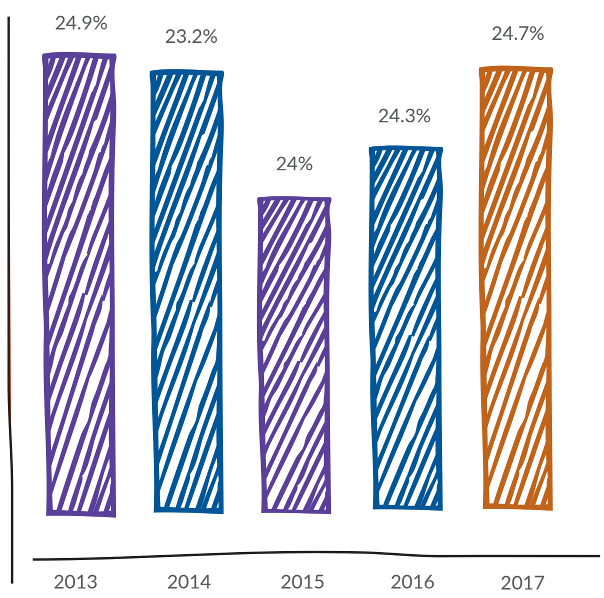
- Power Stations
- Utility Power Generation
- Drilling Platforms
- Network Vaults
- Fenced Electrical Areas

# A Numbers Comparison

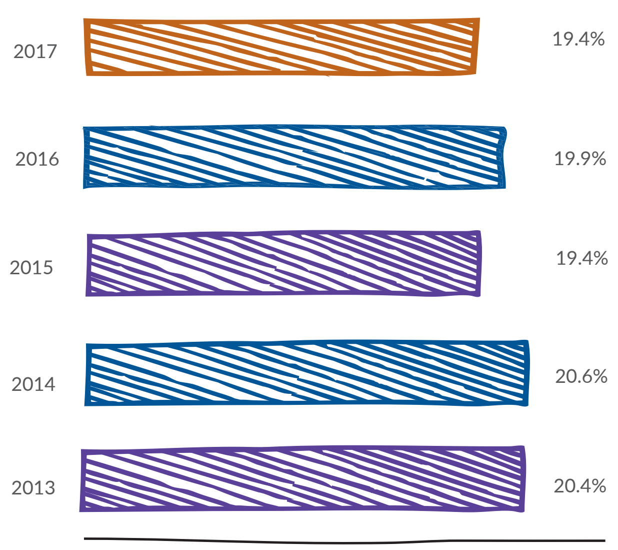
## Sales
(in thousands of dollars)



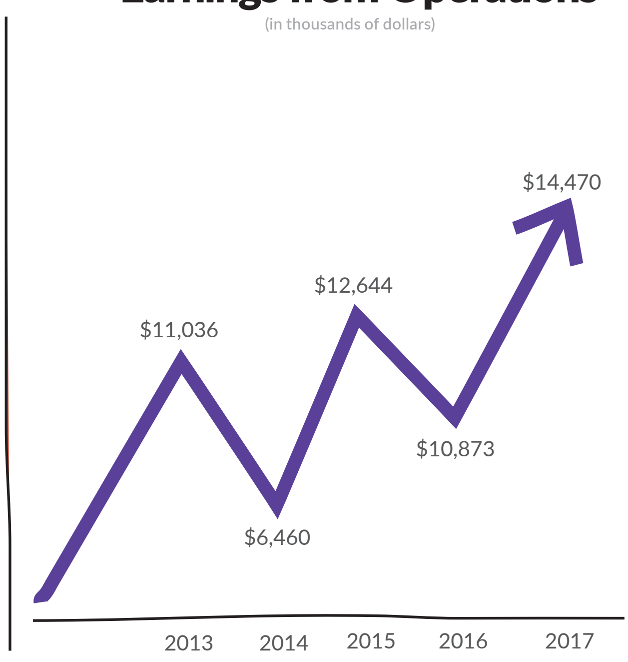

## Gross Margin %




## Selling, General and Administrative Expense Percentage of Sales

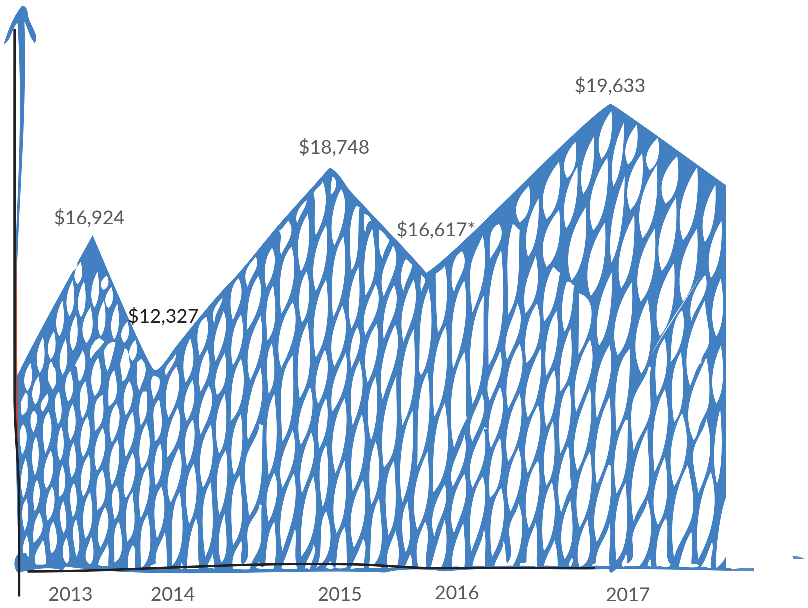



## Earnings from Operations
(in thousands of dollars)



## EBITDA*

* adjusted EBITDA (in thousands of dollars)

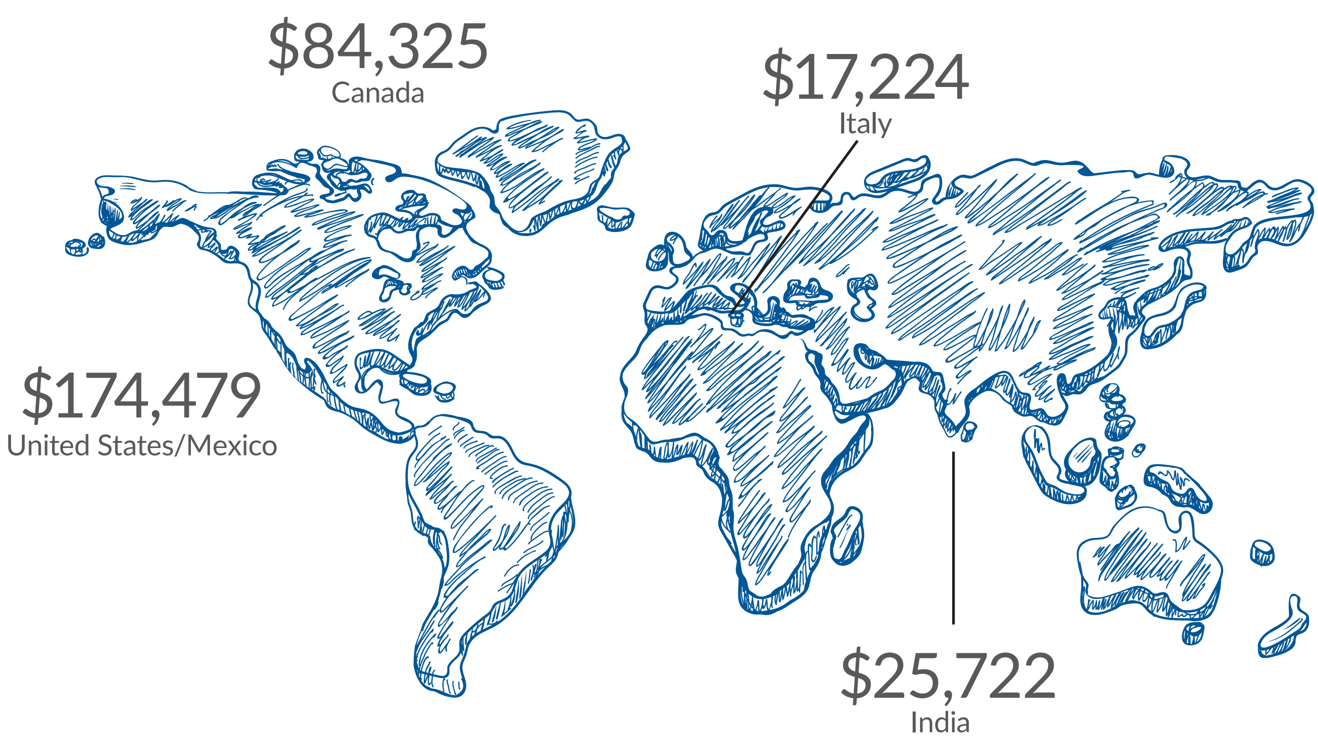



## Debt to Equity Ratio

(in dollars)


## Geographic Sales

(in thousands of dollars)



# Management's Discussion and Analysis

Hammond Power Solutions is a solid company that has performed better than most of our competitors due to our diversity and operational strengths.

The combination of a secure financial foundation, strong business fundamentals and strategic vision, positions HPS for growth as well as additional long-term stakeholder value.

Hammond Power Solutions Inc. ("HPS" or the "Company") is a leader in the design and manufacture of custom electrical engineered magnetics, standard electrical dry-type, cast resin and liquid filled transformers. Advanced engineering capabilities, high quality products and fast responsive service to customers' needs have established the Company as a technical and innovative manufacturer serving the electrical and electronic industries. The Company has manufacturing plants in Canada, the United States ("U.S."), Mexico, Italy and India.

The following is Management's Discussion and Analysis ("MD&A") of the Company's consolidated operating results for the years ended December 31, 2017 and 2016, and should be read in conjunction with the accompanying Consolidated Financial Statements of the Company as at December 31, 2017 and 2016, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This information is based on Management's knowledge as at March 27, 2018. All amounts in this report are expressed in thousands of Canadian dollars unless otherwise noted. Additional information relating to the Company may be found on SEDAR's website at www.sedar.com or on the Company's website at www.hammondpowersolutions.com.

## Caution regarding forward-looking information

This MD&A contains forward-looking statements that involve a number of risks and uncertainties, including statements that relate to among other things, HPS' strategies, intentions, plans, beliefs, expectations and estimates, and can generally be identified by the use of words such as "may", "will", "could", "should", "would", "likely", "expect", "intend", "estimate", "anticipate", "believe", "plan", "objective" and "continue" and words and expressions of similar import. Although HPS believes that the expectations reflected in such forward-looking statements are reasonable, such statements involve risks and uncertainties, and undue reliance should not be placed on such statements. Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied in such statements. Important factors that could cause actual results to differ materially from expectations include but are not limited to: general business and economic conditions (including but not limited to currency rates); changes in laws and regulations; legal and regulatory proceedings; and the ability to execute strategic plans. HPS does not undertake any obligation to update publicly or to revise any of the forward-looking statements contained in this document, whether as a result of new information, future events or otherwise, except as required by law.



## Additional GAAP and Non-GAAP measures

This document uses the terms "earnings from operations" which represents earnings before finance and other costs/ (income) and income taxes. "EBITDA" is also used and is defined as earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA represents EBITDA adjusted for loss on disposal of product line, impairment of goodwill, restructuring charges and foreign exchange gain or loss. Operating earnings, EBITDA and Adjusted EBITDA are some of the measures the Company uses to evaluate the operational profitability. The Company presents EBITDA to show its performance before interest, taxes and depreciation and amortization. Management believes that HPS shareholders and potential investors in HPS use additional GAAP and non-GAAP financial measures, such as operating earnings, EBITDA and Adjusted EBITDA in making investment decisions about the Company and to measure its operational results. A reconciliation of earnings from operations, EBITDA and Adjusted EBITDA to net earnings for the years ended December 31, 2017 and December 31, 2016 is contained in the MD&A. Earnings from operations, EBITDA and Adjusted EBITDA should not be construed as a substitute for net earnings determined in accordance with IFRS.

"Order bookings" represent confirmed purchase orders for goods or services received from our customers. "Backlog" represents all unshipped customer orders. "Book value per share" is the total shareholders' equity divided by the average outstanding shares. The terms "earnings from operations", "EBITDA", "adjusted EBITDA", "order bookings", "backlog" and "book value per share" do not have any standardized meaning prescribed within IFRS and therefore may not be comparable to similar measures presented by other companies.

The Company's 2017 consolidated financial statements, which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016, the consolidated statements of earnings, comprehensive income, changes in equity and cash flows for the years ended December 31, 2017 and December 31, 2016, and Notes thereto, have been prepared using IFRS.

## Overview

With an established global market presence and a focus on market growth, HPS is positioned as a transformer industry leader providing custom and standard order solutions, broad product offerings, market access through multiple sales channels and outstanding quality products. The Company's operational initiatives and strategic vision culminate to achieve these competitive differentiators.

2017 indicated signs of moderate economic improvement globally after several years of lackluster markets and economic instability. HPS' sales volume increased as certain electrical markets showed indicators of strengthening. The Company continued to achieve market share growth in the face of long-term negative market conditions, particularly in the gas and oil industry.

HPS remains steadfast in its operational execution.

The Company is anchored to a strong financial base with a clear strategic vision for growth. HPS is committed to producing quality, innovative and diverse transformers and related magnetic products. The international companies acquired over the last number of years demonstrate our commitment to sales growth and product diversification. HPS' increased global footprint has become a gateway to new customers and markets as well as new technologies. These strengths are the key to future revenue and earnings growth. Our transformer core manufacturing joint venture, Corefficient S. de R.L. de C.V. ("Corefficient"), vertically integrates our raw material supply line – providing a competitive advantage.

2017 was a financially stronger year for HPS influenced by a number of factors: a strengthening global economy, increased organic customer sales, market share growth, improved gross margin rates and a decrease in the volatility of foreign exchange rates. These factors all had a positive impact on HPS' financial results. Although lagging, the financial performance of Corefficient has improved as the joint venture continues to build its trade sales customer base. In 2017, the Company restructured our Italian operations to advance its financial performance. Through the sale of the VPI transformer product line, the Company was able to reduce excess capacity and workforce costs. All of these factors contributed to improved 2017 financial performance and positions HPS for future financial performance growth. HPS also achieved market share growth and maintained an overall healthy financial position throughout the implementation of operational initiatives and longer-term strategic projects.

HPS continues to focus on sales growth, gross margin and operational improvement, which are all vital in delivering consistent strong financial performance. Globally in the United States ("U.S."), Canada, Europe and Asia, HPS is well situated for electrical industry market share growth and continues to be a leader in the markets it serves. The Company continues to build our product capabilities, cost effectiveness and market presence.

Industry outlook indicates continued global economic growth. There is optimism of further market improvement over the next 12 to 18 months, particularly in North America and India. HPS maintains a heightened awareness of the precarious market conditions in Europe, geopolitical instability, particularly in the U.S., the unpredictability of foreign currencies and resource-based commodity cost uncertainty.

The benefit of HPS not being single market dependent, allows the capitalization of growth in expanding market segments while counterbalancing the impact of cyclical market declines. While continued sales variability is expected with fluctuations in the markets and industries of our customers which have a direct impact on HPS revenue, there are indications that market activity is increasing. A portion of annual sales influencing quarterly sales fluctuations will continue to be derived from major customer projects – for which exact timing is difficult to predict. The Company remains attentive and not complacent, calculating the risks and opportunities that are present, unyielding in the execution of our strategies. There are many opportunities to be recognized. Sales and order booking rates continue to grow due to the execution of sales growth projects in strategic target markets delivering additional market share penetration, new account development and expansion of organic sales.

HPS remains confident that the business base which we have built and shaped, combined with our strategic vision, is in support of and will help to generate future growth. The Company continues to develop new market opportunities which will come from organic and new customer sales expansion, product and technology development, cost effectiveness and manufacturing flexibility. We are aware of the need to plan and build for the future and continue to forcefully confront the profitability pressures we are facing. Our capabilities are expanded through our multi-national operations which aid in providing expanded market opportunities, allowing HPS to deliver solid revenue and profitability increases. The Company's commitment to continuous improvement, cost reduction, improved efficiencies and overall cost effectiveness will assist in reaching these goals.

The Company has a strong balance sheet, resilient liquidity and a committed credit facility available to implement operational plans, investment strategies and support growth initiatives. The combination of a secure financial foundation, strong business fundamentals and strategic vision, positions HPS for growth as well as additional long-term stakeholder value. The future of HPS is not only in its focus on market share and sales growth, but also on improving its cost competitiveness.

Subsequent to the 2017 year end, the terms and conditions under an agreement to purchase the remaining 15% economic interest of Hammond Power Solutions Private Limited from a non-controlling shareholder for 76,933,000 Indian Rupees (approximately $1,511,000 CAD) were fulfilled. The Company completed the transaction on January 10, 2018. This increases HPS' equity ownership of India to 100% which allows HPS to further benefit from the sales growth and profitability of Indian operations, while allowing autonomy to make strategic and operational decisions.

We are confident in our strategic initiatives, including revenue growth, cost reductions, manufacturing improvements and developing new technologies. Through these strengths, the Company will further expand market share by leveraging its broad product offering, global reach and strong financial position.

HPS is positioned well and is confident in the vision of the future.

## Sales

Sales in 2017 were $301,750 as compared to sales of $274,793 in 2016, a significant increase of $26,957 or 9.8%.

U.S. market sales (stated in Canadian dollars) were $174,479, an increase of $14,497, or 9.1%, compared to 2016 sales of $159,982. U.S. sales, (stated in U.S. dollars), have increased from $120,756 in 2016 to $134,898 in 2017, an increase of $14,142 or 11.7%. The U.S. market attained increases in the North American Electrical Distributor ("NAED"), motor control, switchgear and petrochemical markets. These gains are offset by decreases in the power control market.

Canadian sales were $84,325, an increase of $6,614 or 8.5% as compared to sales of $77,711 in 2016. Within the Canadian market, there have been increases in the NAED, mining and motor control markets. Canadian sales were negatively impacted by softer technical services and utilities markets.

The Company made notable gains in market growth in our international operations in 2017. International sales increased $5,846 or 15.8%, finishing at $42,946 for the year versus sales of $37,100 in 2016. Indian sales increased 37.9% compared to 2016 sales volume. This growth in India is due to stronger solar market activity, organic and new customer growth and an increase in general economic activity.

2017 Italian operations experienced a 6.6% decline in sales volume from 2016. As the European market continues to be a challenge, the Company decided to restructure the Italian organization, selling the VPI portion of the business in November 2017 maximizing manufacturing throughput in one facility. The details of this transaction are further outlined in the restructuring section of the MD&A.

Sales were also negatively impacted by the weakening of the U.S. dollar relative to the Canadian dollar. The average U.S. to Canadian exchange rate for 2017 was $1.298 versus $1.325 in 2016, a U.S. dollar weakening of 2.0%. The decreased value of the U.S. dollar obscures the U.S. dollar sales increase for 2017.

HPS' commitment to its growth strategy is evidenced by its capital expenditure program, vertical integration strategies and recent restructuring activities. Past acquisitions have broadened the Company's manufacturing capabilities and product offering in cast resin technology as well as expanded the HPS footprint into new geographical markets. The Company will continue to grow market share globally as a result of expanded product offerings, the addition of new customers, geographically diverse manufacturing facilities and extended market reach.

Our market diversification strategies provide a business hedge, as the Company is not single market or industry dependent. The Company's strategies relating to consistent quality, competitive product design, expertise in custom engineered products, global presence and product breadth supported sales growth in several market segments. HPS is also growing its market share through distributor conversions and its custom transformer capabilities.

Stated by geographic segment, sales in the U.S. were 57.8% of our total sales in 2017 versus 58.2% in 2016. Sales in Canada were 27.9% in 2017 as compared to 28.3% last year and International sales accounted for 14.3% of the Company's overall sales in 2017 compared to 13.5% in 2016.

The Company's expanded product offering, organic customer diversity, new customer additions and market reach supports HPS' global market share. The Company's emphasis is on ensuring value to our customers by providing product choice, consistent quality, competitive pricing for custom product and investment in development of new products. These factors combined with a strong, effective distribution channel and multi-national manufacturing capabilities, will continue to be a competitive advantage for the Company and important to continued revenue growth.

### Order bookings and backlog

Overall, 2017 bookings increased by 8.4% over the prior year. In 2017, direct sales bookings increased by 8.0% and bookings in the distributor channel had an increase of 9.0%. The increase in direct channel sales bookings was impacted by significant booking increases in North American booking rates – due to a rise in project business, orders from Canadian Utilities and bookings from customers in the traditional markets of motor control, switchgear and mining. Distributor channel sales bookings were strong in both the U.S., and Canadian markets due to the strengthening of demand in a broad base of business activities.

The Company's December 31, 2017 backlog increased by 9.2% as compared to December 31, 2016, due to the aforementioned higher bookings in North America.

It is expected the combination of the Company's strategic sales initiatives, expanded distributor network and new products will translate into a further rise in booking rates.

HPS is sensitive to the volatility and unpredictability of current global economies and the impact that this could have on booking trends. While several markets are seeing positive quotation and order trends, the Company is very cognizant that it may see some volatility and unpredictability in longer term booking rates.

### Gross margin

The Company achieved an increased gross margin rate of 24.7% in 2017 versus 24.3% in 2016, an improvement of 0.4% of sales. The lift in margin rate can be attributed to a combination of pricing gains, product and customer mix, geographic blend, cost reductions and higher manufacturing throughput. During 2017, foreign currency fluctuations have had a minimal net unfavourable impact on the gross margin rate. HPS' achievement of the current gross margin rate, and the ability to continually maintain a consistent rate, is noteworthy, as the Company continues to experience negative selling price pressures due to the available excess capacity currently in the industry. The Company continues to combat competitor shortsighted pricing strategies through its total value-added engineered solutions.

The Company continues to implement changes to protect the gross margin rate. As a result of increased sales and improvement in the gross margin rate, gross margin dollar contribution increased $7,494 or 11.2% finishing 2017 at $74,404 versus $66,910 in 2016.

The Company implemented a restructuring strategy, in both North America and Italy, to reduce managed salary costs, favorably contributing to the gross margin rate. These cost reductions support the Company's competitiveness in the marketplace and position HPS appropriately for the future.

HPS is currently investing in the support of future sales growth, geographic diversification and new product development. The Company is committed to its growth strategies despite the shorter-term dilutive effect these investments have had on gross margin rates. As sales grow, the impact that higher manufacturing throughput will have on the absorption of factory overheads, will favourably impact margin rates. Gross margin rates are supported by the maintenance of market prices combined with material procurement and engineering cost reduction initiatives.

The quotation activity, backlog growth and increased sales continue to provide certain modest signs of economic improvement. Markets continue to be somewhat erratic however, and can have significant impacts on financial results. Looking forward, HPS remains cautiously optimistic for the future as growth will be realized in some markets along with a decline in others – underscoring the volatility of markets and sales demand. To manage the impact, the Company has continued to advance its geographic footprint, implemented a number of cost reduction activities, invested in new product development and expanded manufacturing capabilities. A diversified geographic approach supports anticipated growth from implemented market strategies and subsequent economic improvement.

The Company's capacity expansion strategy is paramount for future increased sales demand. HPS is dedicated to identifying and implementing productivity enhancements, increased productivity improvements and cost reductions in the entire organization. HPS is confident that these actions will increase future margin rates.

### Selling and distribution expense

Total selling and distribution expenses were $34,120 for 2017 versus $29,886 in 2016, an increase of $4,234 or 14.2%. On a percentage-of-sales basis, total selling and distribution increased slightly to 11.3% of sales in 2017 from 10.9% in 2016. The increased sales for the year resulted in higher variable selling expenses, namely, increased commission expense of $380 and higher freight expense of $1,565.

### General and administrative expense

General and administrative expenses in 2017 were $24,428 compared to $24,734 for 2016, a slight decrease of $306 or 1.2%. On a percentage-of-sales basis these costs decreased from 9.0% in 2016 to 8.1% in 2017. Abnormal bad debt provisions primarily related to a customer dispute in India, resulting in a provision of $900 were significantly offset by restructuring initiatives in the year and a decrease in U.S. denominated expenses of $142.

These costs support our strategic growth initiatives and an investment in our people, specifically in the areas of sales, engineering and information services. While investing in growth and financial performance is paramount, HPS remains very cognizant of prudent general and administrative expense management.

### Restructuring charges

In support of improving the Company's cost competitiveness and profit enhancement, HPS executed several strategic restructuring activities during the year.

In Quarter 1, 2017, the Company implemented a North American cost reduction initiative through reducing manufacturing employee costs by $287 and general and administrative expenses of $529.

In Quarter 4, 2017, HPS sold the property, plant and equipment as well as the intangibles and inventory of the VPI product line of operations in Italy – resulting in the recognition of a loss-on-disposal of $1,022. This strategic decision eliminated excess capacity and reduced personnel costs resulting in further cost reductions of $60 in manufacturing employee costs and $510 in general and administrative costs.

### Earnings from operations

Earnings from operations were $14,470 in 2017, as compared to $10,873 in 2016, an increase of $3,597 or 33.1%.

The change in earnings from operations is a result of the increase in sales and gross margin contribution offset by an increase in selling expenses and restructuring charges.

Earnings from operations are calculated as outlined in the following table:

| | 2017 | 2016 |
|---|---|---|
| Net earnings for the year | $ 6,114 | $ 1,793 |
| Add: | | |
| Income tax expense | 5,731 | 4,663 |
| Finance and other costs | 2,625 | 4,417 |
| Earnings from operations | $ 14,470 | $ 10,873 |

### Interest expense

Interest expense for the year-ended December 31, 2017, finished at $1,263 as compared to $1,067 in 2016, an increase of $196 or 18.4%. A rise in interest expense year-over-year was due to the timing of operating debt levels throughout the year, a result of operational capital expenditures, restructuring charges and higher working capital requirements. Interest expense includes all bank fees.

### Foreign exchange gain

The foreign exchange gain in 2017 of $137 related primarily to the transactional exchange gain of the Company's U.S. dollar trade accounts payable in Canada, compared to a foreign exchange loss of $844 in 2016. A decrease in the foreign exchange expense for the year is related to the decreased volatility in the exchange rates during the year – primarily the U.S. dollar which declined 2.0% relative to the Canadian dollar in 2017. This ongoing volatility is managed by HPS' foreign exchange contract hedging program. At December 31, 2017, the Company had outstanding foreign exchange contracts in place for 15,200 EUR and $10,000 U.S. Both of these contracts were implemented as an economic hedge against translation gains and losses on inter-company loans and outstanding foreign exchange contracts for $41,000 U.S. – an economic hedge of U.S. dollar denominated accounts payable in the Canadian operations of HPS.

### Earnings before income tax

2017 earnings before income taxes increased to $11,845 as compared to $6,456 in 2016, an increase of $5,389 or 83.5%. The main contributors to the higher net earnings were a result of sales and gross margin growth, positive foreign exchange movements and improved results in the Company's joint venture resulting in the recognition of a smaller loss. These improvements were offset by lower sales in Italy, restructuring charges and a loss on the disposal of the Italian product line.

### Income taxes

Income tax expense for 2017 was $5,731 as compared to $4,663 in 2016, an increase of $1,068 or 22.9%. The consolidated effective tax rate for 2017 decreased to 48.4% versus 72.2% last year – a difference of 23.8%. In 2016, a non-cash impairment charge against goodwill and other non-tax-deductible costs, including stock option expense, increased the effective tax expense rate by 18.0%. The 2017 rate for active business and manufacturing and processing decreased the effective tax rate by 3.3%.

The Company's deferred tax assets and liabilities are related to temporary differences in various tax jurisdictions, primarily reserves and allowances, which are not deductible in the current year. A difference in the carrying value of property, plant and equipment and intangible assets for accounting purposes and for tax purposes is a result of business combination accounting and a different basis of depreciation utilized for tax purposes. Income tax provision is explained further in note 15 in the Notes to Consolidated Financial Statements included in our 2017 Annual Report.

### Net earnings

Net earnings for 2017 finished at $6,114 compared to net earnings of $1,793 in 2016, an increase of $4,321, or 241.0%. The improvement in earnings is a result of higher sales, sales mix, improved gross margin rate, positive foreign exchange movements, decreased losses on investment in the joint venture and the prior year impairment of goodwill. This was partially offset by the loss on the disposal of the VPI product line.

### EBITDA

EBITDA for the year-ended December 31, 2017 was $19,633 versus $14,356 in 2016, an increase of $5,277 or 36.8%. Adjusted for foreign exchange gain/loss, non-cash impairment charge against goodwill, loss on disposition and restructuring charges, adjusted EBITDA for 2017 was $21,904 versus $16,617 in 2016, an increase of $5,287 or 31.8%.

EBITDA and adjusted EBITDA is calculated as outlined in the following table:

| | **2017** | 2016 |
|---|---|---|
| Net earnings | $ 6,114 | $ 1,793 |
| Add: | | |
| Interest expense | 1,263 | 1,067 |
| Income tax expense | 5,731 | 4,663 |
| Depreciation and amortization | 6,525 | 6,833 |
| EBITDA | $ 19,633 | $ 14,356 |
| Add: | | |
| Loss on disposition | 1,022 | – |
| Impairment of goodwill | – | 1,417 |
| Foreign exchange (gain) loss | (137) | 844 |
| Restructuring charges | 1,386 | – |
| Adjusted EBITDA | $ 21,904 | $ 16,617 |

### Summary of quarterly financial information (unaudited)

| Fiscal 2017 Quarters | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| Sales | $ 72,362 | $ 78,874 | $ 74,685 | $ 75,829 | $ 301,750 |
| Net earnings | $ 1,084 | $ 2,842 | $ 1,563 | $ 625 | $ 6,114 |
| Net earnings per share – basic | $ 0.09 | $ 0.25 | $ 0.14 | $ 0.05 | $ 0.53 |
| Net earnings per share – diluted | $ 0.09 | $ 0.25 | $ 0.14 | $ 0.04 | $ 0.52 |
| Average U.S. to Canadian exchange rate | $ 1.3225 | $ 1.3468 | $ 1.2531 | $ 1.2704 | $ 1.2982 |

| Fiscal 2016 Quarters | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| Sales | $ 68,722 | $ 69,138 | $ 62,860 | $ 74,073 | $ 274,793 |
| Net earnings | $ 884 | $ 517 | $ 99 | $ 293 | $ 1,793 |
| Net earnings per share – basic | $ 0.07 | $ 0.05 | $ 0.01 | $ 0.03 | $ 0.16 |
| Net earnings per share – diluted | $ 0.07 | $ 0.05 | $ 0.01 | $ 0.03 | $ 0.16 |
| Average U.S. to Canadian exchange rate | $ 1.376 | $ 1.287 | $ 1.306 | $ 1.332 | $ 1.325 |

Quarterly sales for 2017 all increased from the same quarter in 2016 as a result of improvements in general economic conditions and market share growth. Year-to-year quarterly fluctuations in both sales and income are affected by changes in foreign exchange rates, product mix, changing economic conditions and competitive pricing pressures.

Fluctuations in exchange rates resulted in a decreased loss in foreign exchange each quarter of 2017. Year-to-date there was a foreign exchange gain of $137 in 2017 compared to a loss of $844 in 2016. Reduced volatility of exchange rates had a positive impact on quarterly earnings.

Corefficient had reduced losses for each quarter of 2017 compared to losses in 2016.

Changes in product mix, changing economic conditions and competitive pricing pressures have all had an impact on the year-over-year quarterly fluctuations for both sales and income.

### Quarter 4, 2017 financial results

| | Quarter ended December 31, 2017 | Quarter ended December 31, 2016 |
|---|---|---|
| Sales | $ 75,829 | $ 74,073 |
| Impairment of goodwill | $ – | $ 1,417 |
| Restructuring charges | $ 570 | – |
| Earnings from operations | $ 3,774 | $ 4,633 |
| Exchange (gain) loss | $ (85) | $ 643 |
| Loss on disposition | $ 1,022 | – |
| Net earnings | $ 625 | $ 293 |
| Earnings per share – basic | $ 0.05 | $ 0.03 |
| Earnings per share – diluted | $ 0.04 | $ 0.03 |
| Cash provided by operations | $ 421 | $ 17,255 |

Sales for the quarter ended December 31, 2017 were $75,829, an increase of $1,756 or 2.4% from the comparative quarter last year, which is reflective of increased market activity.

Quarter 4, 2017 gross margin dollars decreased slightly by $25 compared to Quarter 4, 2016. The gross margin rate decreased to 25.3% in Quarter 4, 2017 versus 25.9% in Quarter 4, 2016 as a result of sales mix.

Total selling and distribution expenses amounted to $9,050 in Quarter 4, 2017 versus $7,217 in Quarter 4, 2016, an increase of $1,833 or 25.4%. The increase in these expenses is attributable to increased sales in the quarter. Selling and distribution expenses as a percentage of sales, have increased to 11.9% in 2017 compared to 9.7% in 2016.

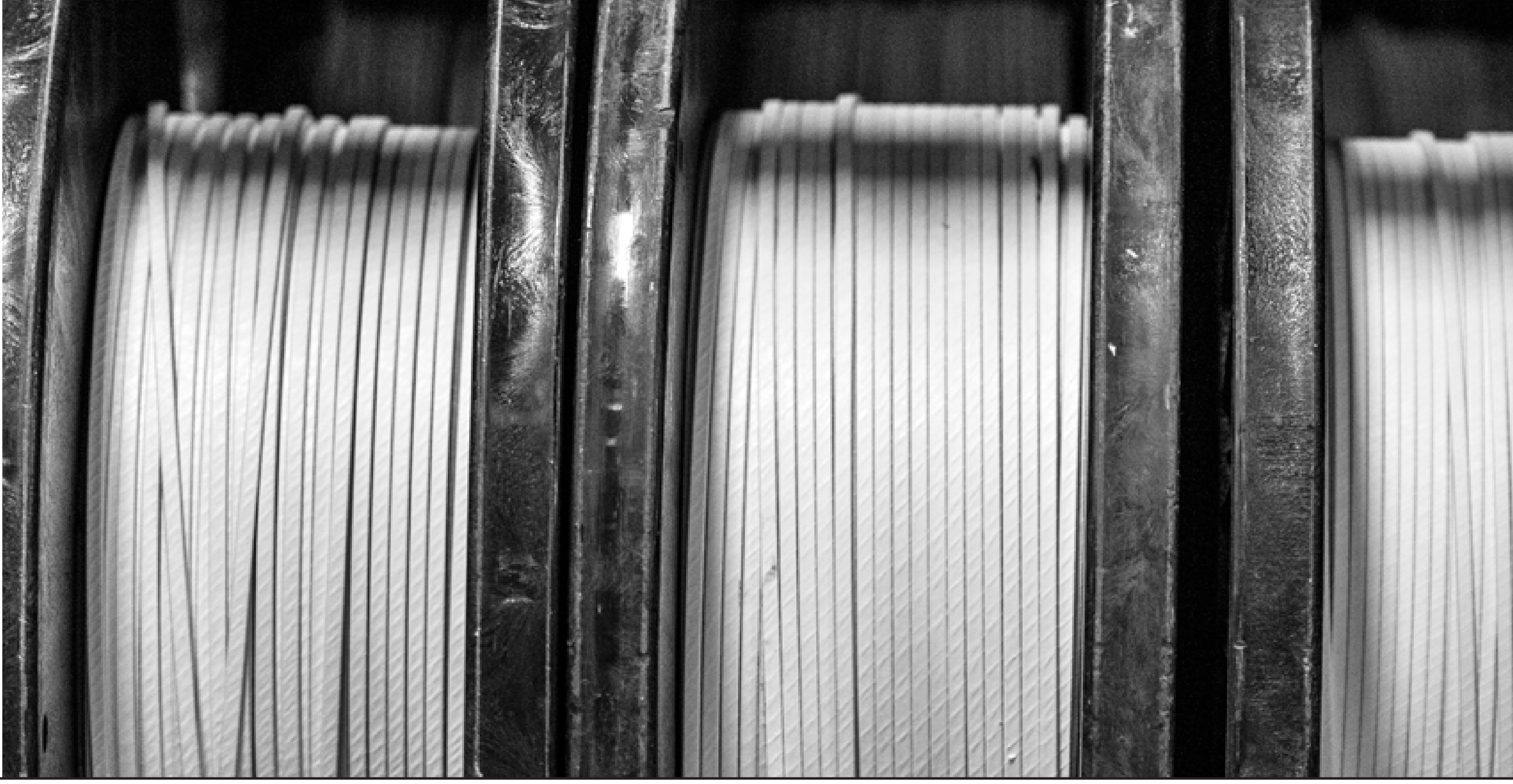
General and administrative expenses for Quarter 4, 2017 totaled $5,793 – a slight decrease of $102 or 1.7% when compared to Quarter 4, 2016 costs of $5,895. The consistency is a result of prudent and conservative spending.

Foreign exchange gain in Quarter 4, 2017 was $85 compared to a foreign exchange loss of $643 in Quarter 4, 2016. The majority of Quarter 4, 2017 foreign exchange gain was a result of transactional losses in Canada due to the strengthening of the U.S. dollar relative to the Canadian dollar in the quarter being offset by gains on settlements of foreign exchange contracts.

During Quarter 4, 2017 the VPI product line was sold, reducing excess capacity and employment expenses. This transaction resulted in $570 in restructuring charges as well as a loss on disposal of $1,022.

Earnings from operations for the quarter were positively impacted by increased sales, offset by higher selling and distribution expenses as well as a loss on disposal of product line and restructuring charges. Quarter 4, 2016 was negatively impacted by a non-cash impairment of goodwill as at December 31, 2016 as the Company determined that the recoverable amount of the Italian cash generating unit ("CGU") was lower than its carrying value (a cash generating unit is the smallest group of assets that independently generates cash flow and whose cash flow is largely independent of the cash flows generated by other assets). Quarter 4, 2017 earnings from operations decreased $859 from $4,633 in Quarter 4, 2016 to $3,774 in Quarter 4, 2017.

Quarter 4, 2017 income tax expense was $2,203 on earnings before income taxes of $2,828 (an effective tax rate of 77.9%) as compared to an income tax expense of $2,750 on earnings before income taxes of $3,043 (an effective tax rate of 90.4%) in Quarter 4, 2016 – a decrease of $547. The lower effective tax rate in 2017 was primarily the result of the 2016 non-deductible impairment charge against goodwill at Hammond Power Solutions S.p,A ("HPS Italy") and no recognition of the tax benefit of losses.



Net earnings for Quarter 4, 2017 were $625 compared to $293 in Quarter 4, 2016, an increase of $332 or 113.3%.

Cash provided by operations for Quarter 4, 2017 was $421 versus $17,255 in Quarter 4, 2016, a decrease of $16,834. A decrease in the cash generated from operations was due primarily to the early collection of $9,849 accounts receivable in late 2016. This typically would have been collectable in 2017 under normal payment terms, impacting the change in non-cash working capital from a use-of-cash in the quarter of $1,403 compared to cash generation of $10,942 during Quarter 4 in 2016.

Operating lines of credit net of cash, finished the year in a net operating debt position of $16,983 as at December 31 2017, an increase of $5,665 as compared to a net debt balance of $11,318 as at December 31, 2016. The 2017 increased net operating debt position is reflective of increased working capital requirements.

## Capital resources and liquidity

The Company continued to focus on generating cash from operations, debt management, investment and liquidity.

Cash provided from operating activities during 2017 was $1,032 versus $15,216 in 2016, a decrease in cash generated from operations of $14,184. This decrease in cash generated from operating activities was due to increased working capital usage partially offset by higher net earnings. Increased investment in non-cash working capital used cash of $13,715 in 2017 versus generated cash of $4,801 in 2016, resulted in a decrease of $18,516 from 2016. The change in non-cash working capital of $13,715 for 2017 was primarily a result of increases in accounts receivable and foreign exchange adjustments.

Accounts receivable finished the year at $59,170 as compared to $49,969 as at December 31, 2016, an increase of $9,201 – a result of higher Quarter 4 sales in 2017 compared to 2016. At the end of 2016, due to accelerated payment terms, the Company had an increase in accounts receivable collections in Quarter 4, 2016. The receivable balance returned to typical historical amounts as at December 31, 2017. During 2017, the focus has been on customer accounts receivable collections cycle time and inventory turnover rates.

The Company's days' sales outstanding ratio remains below industry standards, which can be attributed to effective credit policies and tightly managed accounts receivable administration.

Inventories finished the year at $38,340 as at December 31, 2017, versus $41,163 as at December 31, 2016, a decrease of $2,823. The lower inventory levels in 2017 were attributed to a surge in sales in Quarter 4, 2017 as well as the sale of the VPI inventory.

Accounts payable and accrued liabilities increased by $2,858 finishing at $45,647 as at December 31, 2017 compared to $42,789 at the end of 2016. The increase in accounts payable is related to the timing of purchases from and payments to suppliers.

Net income taxes receivable were $1,564 (income taxes receivable of $1,701 less income taxes payable of $137) as at December 31, 2017, versus net income taxes receivable of $598 (income taxes receivable of $1,155 less income taxes payable of $557) as at December 31, 2016 a change of $966.

Cash used in financing activities was $12,700 in 2017, compared to $463 in 2016, a change of $12,237. The increase in cash used during 2017 can be attributed to repayment of the bank operating lines.

Cash used in investing activities in 2017 decreased $7,176 from $10,141 in 2016 to $2,965 in 2017, a result of the prior year balance including additional contributions to the joint venture and the purchase of a non-controlling interest in the Indian operations. There was a slight increase in capital spending of $155 over the prior year, totaling $2,319 in 2017 – compared to $2,164 for 2016. Expanded manufacturing capacity and new product development were areas of capital expenditure spending. In addition there was "normal" maintenance capital invested at all facilities and manufacturing product mandated projects.

Bank operating lines of credit finished the year at $27,755 as at December 31, 2017, compared to $36,507 as at December 31, 2016 resulting in a decrease of $8,752 in the year.

Overall bank lines of credit, net of cash, resulted in net debt of $16,983 as at December 31, 2017, an increase of $5,665 as compared to a net debt balance of $11,318 as at December 31, 2016, primarily reflecting additional working capital requirements.

All bank covenants were met as at December 31, 2017, and the Company was in compliance with its covenants throughout the year.

The Company's growth strategy continues to include the pursuit of strategic acquisitions and partnerships, which would be funded primarily by cash from operations and existing available credit facility, against which the Company has currently drawn $16,983, supplemented by debt financing as required. The Company is well funded, with sufficient cash and debt capacity to fund its operating activities, investments and strategic growth initiatives. The Company has several alternatives to fund future capital requirements, including its existing cash position, credit facility, future operating cash flows and debt or equity financing. The Company continually evaluates these options to ensure that the appropriate mix of capital resources is effectively managed for current and future requirements.

The Company has minimal outstanding capital expenditure commitments of $20 primarily for manufacturing efficiency improvement projects and product development. These ongoing projects are in support of future business development and growth.

Additional details of our change in non-cash working capital can be found in note 24 in the Notes to Consolidated Financial Statements contained in our 2017 Annual Report.

### Credit Agreement

During the second quarter of 2016, the Company entered into an amended credit agreement which expires in June 2021, consisting of a $40,000 U.S. revolving credit facility and a $10,000 U.S. delayed draw credit facility. This is an unsecured 5-year committed credit agreement that provides financing certainty for the future. This agreement better aligns our Canadian and U.S. banking requirements, supports our hedging strategies and provides financing for our operational requirements and capital for our strategic initiatives.

The Company has access to a 4,070 EUR facility that matures in May 2018, made up of a 3,750 EUR revolver and 250 EUR overdraft facility, as well as a 70 EUR letter of credit line. Hammond Power Solutions Private Limited ("HPS India") maintains a demand credit facility of 325,000 INR consisting of a 178,000 INR short-term working capital demand loan facility, a 189,000 INR bank guarantee and letters of credit facility as well as a 8,000 INR bill discounting export facility.

Based on exchange rates in effect at December 31, 2017, the combined Canadian dollar equivalent available prior to any utilization of these facilities was $76,216.

### Contractual obligations

The following table outlines payments due for each of the next 5 years and thereafter related to debt, lease, purchase and other long-term obligations.

| | 2018 | 2019 | 2020 | 2021 | 2022 | Total |
|---|---|---|---|---|---|---|
| Operating leases | $ 2,094 | $ 1,622 | $ 571 | $ 167 | $ 128 | $ 4,582 |
| Accounts payable and accrued liabilities | 45,647 | – | – | – | – | 45,647 |
| Capital expenditure purchase commitments | 20 | – | – | – | – | 20 |
| Operating lines of credit | 27,755 | – | – | – | – | 27,755 |
| Total | $ 75,516 | $ 1,622 | $ 571 | $ 167 | $ 128 | $ 78,004 |

### Put option liability

**Hammond Power Solutions Private Limited - India**

In relation to the non-controlling interest in Hammond Power Solutions Private Limited ("HPS Pvt. Ltd."), HPS has an irrevocable call option exercisable at any time after February 23, 2016, and in certain other circumstances, to purchase the remaining securities of HPS Pvt. Ltd. from the non-controlling interest at fair value. The Company also has granted a put option, exercisable at any time after February 23, 2019, and in certain other circumstances, to cause HPS to purchase the remaining securities of HPS Pvt. Ltd. at fair value from the non-controlling interests. The exercise price of the call and put option are at fair value; the fair value of the instruments are considered nominal. The Company has not recognized the present value of the redemption price of the put option as a liability as at December 31, 2017 as it is not considered material to the consolidated financial statements. Subsequent to year-end, the Company exercised its call option and purchased the remaining minority interest of HPS Pvt. Ltd. as discussed in note 29 in the Notes to Consolidated Financial Statements contained in our 2017 Annual Report.

**Hammond Power Solutions S.p.A – Italy**

As part of the VPI asset purchase agreement, the lease agreement relating to the Meledo, Italy building includes a put and call sale option related to the leased premises, exercisable within 60 days after September 30, 2023. The call option grants the purchaser an option to purchase the premises for consideration equal to 2,225,000 Euros. The plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375,000 Euros (approximately $563,000 Canadian dollars). If the purchaser does not execute the call option HPS can exercise its put option which grants HPS an option to sell the plant to the purchaser for consideration equal to the same plant purchase price. If the purchaser rejects the put option, the purchaser will pay 500,000 Euros (approximately $750,000 Canadian dollars) as liquidated damages.

## Contingent liabilities

In June 2017, the Corporation received notice of an environmental claim from the owner of a property located near a property that was once partially owned by the Corporation. At this time the Company feels that there is no merit to the claim.

Management is not aware of any other contingent liabilities.

## Regular quarterly dividend

The Company continued with its quarterly cash dividend of six cents ($0.06) per Class A Subordinate Voting Share of HPS and of six cents ($0.06) per Class B Common Share of HPS.

The Quarter 1 dividend was paid on March 24, 2017 to shareholders of record at the close of business on March 17, 2017. The ex-dividend date was March 15, 2017. The Quarter 2 dividend was paid on June 23, 2017 to shareholders of record at the close of business on the 16th day of June 2017. The ex-dividend date was June 14, 2017. The dividend for Quarter 3 was paid on September 29, 2017 to shareholders of record at the close of business on September 22, 2017. The ex-dividend date was September 21, 2017. The Quarter 4 dividend was paid on December 15, 2017 to shareholders of record at the close of business on December 8, 2017. The ex-dividend date was December 7, 2017.

In 2017, the Company has paid a total cash dividend of twenty-four cents ($0.24) per Class A Subordinate Voting Share and twenty-four cents ($0.24) per Class B Common Share.

## Controls and procedures

The Chief Executive Officer and the Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures and for establishing and maintaining adequate internal controls over financial reporting. The control framework used in the design of disclosure controls and procedures and internal control over financial reporting is the 2013 Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("2013 COSO Framework"). Our internal control system was designed to provide reasonable assurance to our Management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with International Financial Reporting Standards. All internal control systems, no matter how well designed, have inherent limitations.

Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

As at December 31, 2017, the Company conducted an evaluation, under the direction and supervision of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2017 such disclosure controls and procedures were operating effectively.

Hammond Power Solutions Inc., the majority shareholder of HPS Pvt. Ltd. raised certain issues and disputes in respect of the methods and manner of management by the non-controlling shareholder who also served as the Managing Director of HPS India. The Company brought forward financial impropriety allegations against the non-controlling shareholder that occurred prior to 2017. The Company engaged a public accounting firm to complete a forensic audit of HPS India and as a result of this audit, the Parties have agreed to settle claims against the minority shareholder. As part of a settlement agreement, the Company received a price reduction in the purchase price of the remaining 15% non-controlling interest's shares completed subsequent to the year end.

The Company has aggressively bolstered its internal controls of the operation which now includes the implementation of a new ERP system.

## Internal controls over financial reporting

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. Our internal control system was designed to provide reasonable assurance to our Management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with International Financial Reporting Standards. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Canadian Securities Administrators require that companies certify the effectiveness of internal controls over financial reporting. It also requires a company to use a control framework such as the COSO Framework to design internal controls over financial reporting. As well, the threshold for reporting a weakness of internal controls over financial reporting should be of a "material weakness" rather than "reportable deficiency." HPS has designed its internal controls in accordance with the COSO Framework and has carried out retesting in 2017, which was completed in the fourth quarter.

As of December 31, 2017 Management, with the supervision and participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting. Based on that assessment, the Chief Executive Officer and Chief Financial Officer have concluded that the internal controls are effective and that there were no material weaknesses in the Company's internal control over financial reporting as of December 31, 2017.

## Changes in internal control over financial reporting and disclosure controls and procedures

During 2017 there were no material changes identified in HPS' internal controls over financial reporting that had materially affected, or were reasonably likely to materially affect HPS' internal control over financial reporting. HPS does carry out ongoing improvements to its internal controls over financial reporting but nothing considered at a material level.

## Subsequent events

### Dividends

On March 1, 2018, the Company declared a quarterly cash dividend of six cents ($0.06) per Class A subordinate voting shares of HPS and a quarterly cash dividend of six cents ($0.06) per Class B common shares of HPS payable on March 22, 2018 to shareholders of record at the close of business on March 15, 2017. The ex-dividend date is March 13, 2018.

### Purchase of Non-controlling Interest

On January 10, 2018, the Company fulfilled the terms and conditions under an agreement to acquire the remaining 15% economic interest of HPS Pvt. Ltd. from a non-controlling shareholder for 76,933,000 INR (approximately $1,511,000 Canadian dollars), resulting in the Company's equity ownership in HPS Pvt. Ltd becoming 100%.

### Risks and uncertainties

The Company's goal is to proactively manage risks in a structured approach in conjunction with strategic planning, with the intent to preserve and enhance shareholder value. However, as with most businesses, HPS is subject to a number of market place, industry and economic-related business risks, which could cause our results to vary materially from anticipated future results. The Company is acutely cognizant of these risks and continually assesses the current and potential impacts that they have on the business. HPS continuously strives to curtail the negative impact of these risks through diversification of its core business, market channel expansion, breadth of product offering, geographic diversity of its operations and business hedging strategies. If any of the following risks were to occur they could materially adversely affect HPS' financial condition, liquidity or results of operations.

These risks include:

**We may not realize all of the anticipated benefits of our acquisitions, divestures, joint ventures or strategic initiatives, or these benefits may take longer to realize than expected.**
In order to be profitable, the Company must successfully execute upon its strategic initiatives and effectively manage the resulting changes in its operations. The Company's assumptions underlying its strategic plans may be subjective, the market may react negatively to these plans, and HPS may not be able to successfully execute these plans, and even if successfully executed, its actions may not be effective or may not lead to the anticipated benefits within the expected time frame.

These strategic initiatives can include acquisitions and joint ventures. To be successful, management will conduct due diligence to identify valuation issues and potential loss contingencies, negotiate transaction terms, complete complex transactions and manage post-closing matters such as the integration of acquired startup businesses. Management's due diligence reviews are subject to the completeness and accuracy of disclosures made by third parties. The Company may incur unanticipated costs or expenses following a completed acquisition, including post-closing asset impairment charges, expenses associated with eliminating duplicate facilities, litigation or other liabilities.

Many of the factors that could have an adverse impact will be outside of management's control and could result in increased costs and decreases in the amount of expected revenues and diversion of management's time and attention. Failure to implement an acquisition strategy, including successfully integrating acquired businesses, could have an adverse effect on our business, financial condition and result of operations.

**We sell to customers around the world and have global operations and, therefore, are subject to the risks of doing business in many countries.**
We do business in a host of countries around the world. Approximately 75% of our sales were to customers outside of Canada. In addition, a number of our manufacturing operations, suppliers and employees are located in many places around the world. The future success of our business depends in large part on growth in our sales in non-Canadian markets. Our global operations are subject to numerous financial, legal and operating risks, such as political and economic instability; prevalence of corruption in certain countries; enforcement of contract and intellectual property rights and compliance with existing and future laws, regulations and policies, including those related to tariffs, investments, taxation, trade controls, product content and performance, employment and repatriation of earnings.

**Our global business translates into conducting business in various currencies, all of which are subject to fluctuations.**
HPS' global footprint exposes the Company to currency fluctuations and volatility and, at times, has had a significant impact on the financial results of the Company. The Company's functional currency is the Canadian dollar with its operating results are reported in Canadian dollars. A significant portion of Company sales and material purchases are denominated in U.S. dollars. There is a natural hedge, as sales denominated in U.S. dollars are partially offset by the cost of raw materials purchased from the U.S., and commodities tied to U.S. dollar pricing. A change in the value of the Canadian dollar against the U.S. dollar will impact earnings, significantly at times. Generally, a lower value for the Canadian dollar compared to the U.S. dollar will have a beneficial impact on the Company's results, while a higher value for the Canadian dollar compared to the U.S. dollar will have a corresponding negative impact on the Company's profitability.

HPS has partially reduced the impact of foreign exchange fluctuations by increasing our U.S. dollar driven manufacturing output, periodically instituting price increases to help offset negative changes and entering into forward foreign exchange contracts.

**Worldwide HPS is subject to, and required to comply with, multiple income and other taxes, regulations and is exposed to uncertain tax liabilities risk.**

The Company operates and is subject to income tax and other forms of taxation in numerous tax jurisdictions. Taxation laws and rates, which determine taxation expenses, may vary significantly in different jurisdictions, and legislation governing taxation laws and rates is also subject to change. Therefore, the Company's earnings may be impacted by changes in the proportion of earnings taxed in different jurisdictions, changes in taxation rates, changes in estimates of liabilities and changes in the amount of other forms of taxation. Tax structures are subject to review by both domestic and foreign taxation authorities. The determination of the consolidated tax provision and liabilities requires significant judgment. Tax filings are subject to audits, which could materially change the amount of current and deferred income tax assets and liabilities.

**We face the potential harms of natural disasters, pandemics, acts of war, terrorism, international conflicts or other disruptions to our operations.**

Our business depends on the movement of goods around the world. Natural disasters, pandemics, acts or threats of war or terrorism, international conflicts, political instability and the actions taken by governments could cause damage to or disrupt our business operations, our suppliers or our customers and could create economic instability. Although it is not possible to predict such events or their consequences, these events could decrease demand for our products or make it difficult or impossible to deliver our products.

**The U.S. political uncertainty and potential for changes in the business environment can lead to legislative changes that could impact business.**

The results of the last U.S. election have created a number of geopolitical risks that could be challenging for the Company. The impact of these political changes can be difficult to predict and can have a pervasive impact on the global business climate. Changes in political leaders can impact trade relations as well as taxes and/or duties. The Company's current structure includes a significant amount of business that crosses borders and any changes in the current trade structure could have a material impact for the Company. The Company's global footprint will be critical to mitigating any impact for political changes that would modify the current trade relationships.

**Our industry is highly competitive.**

HPS faces competition in all of our market segments. Current and potential competitors may have greater brand name recognition, more established distribution networks, access to larger customer bases and substantially greater financial, distribution, technical, sales and market, manufacturing and other resources than HPS does. As a result, those competitors may have advantages relative to HPS; including stronger bargaining power with suppliers that may result in more favourable pricing, the ability to secure supplies at time of shortages, economies of scale in production, the ability to respond more quickly to changing customer demands and the ability to devote great resources to the development, promotion and sales of their products and services. If the Company is unable to compete effectively, it may experience a loss of market share or reduced profitability. We expect the level of competition to remain high in the future.

**Our business is highly sensitive to global and regional economic conditions in the industries we serve.**

Current global economic conditions influence the Company's focus, direction, strategic initiatives and financial performance. To address the current uncertainty, we are focusing our efforts on projects that will increase our market reach, advance our cost competiveness, expand capacity and improve our manufacturing flexibility.

The Company believes that being an agile organization will hold even greater importance in order to respond quickly to both unexpected opportunities and challenges. HPS' management believes that the key to expanding our market share during this economic slowdown is growing our access to a variety of domestic and global markets. This will be achieved through our current and


new Original Equipment Manufacturer ("OEM") and distributor channels.

**The disruption to businesses that can come from unpredictable weather can have an impact on sales volume as customer projects can be delayed or cancelled.** Extreme weather conditions such as heavy rains, flooding, snowfall, tornadoes and hurricanes can potentially have a negative impact on the Company's sales trends and booking rates. When these conditions are present, the Company may see short-term effects of such occurrences due to their unpredictability. This may impact delivery and capacity requirements.

**The business practice of extending credit to customers can lead to a risk of uncollectability.**
A substantial portion of the Company's accounts receivable are with customers in manufacturing sectors and are subject to credit risks normal to those industries. The Company's expansion into emerging markets increases credit risk, which is partially mitigated by progress payments. Approvals are based on trade information, payment history, credit rating and financial analysis. Although the Company has historically incurred very low bad debt expense, the current economic environment conditions elevate this exposure.

**Market supply and demand impact on commodity prices**
An area that has a definite impact on the Company's costs and earnings is the cyclical effects and unprecedented market cost pressures of both copper commodity and steel pricing in the global markets. This risk is mitigated through strategic supply line agreements and alliances in place with major steel suppliers to ensure adequate supply and competitive market pricing.

## Off-balance sheet arrangements

The Company has no off-Balance Sheet arrangements, other than operating leases disclosed in note 14 in the Notes to the Consolidated Financial Statements contained in our 2017 Annual Report.

## Transactions with related parties

The Company had transactions with related parties in 2017, as disclosed in note 22 in the Notes to the Consolidated Financial Statements contained in our 2017 Annual Report.

## Proposed transactions

The Company had no proposed transactions as at December 31, 2017. The Company continues to evaluate potential business expansion initiatives in accordance with its long-term growth strategy.

## Financial instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, long-term lease receivable, note receivable, bank operating lines of credit, accounts payable and accrued liabilities and the following derivative instruments:

At December 31, 2017, the Company had outstanding foreign exchange contracts in place for 13,500 EUR and $10,000 USD both implemented as an economic hedge against translation gains and losses on inter-company loans and $41,000 USD to economically hedge the U.S. dollar denominated accounts payable in the Canadian operations of HPS. The Company had total outstanding foreign exchange contracts in place as at December 31, 2016 for 12,950 EUR, and $7,900 USD as economic hedges against translation gains and losses on inter-company loans and $36,000 USD to economically hedge the U.S. dollar denominated accounts payable in the Canadian operations.

Further details regarding the Company's financial instruments and the associated risks are disclosed in note 26 in the Notes to the Consolidated Financial Statements contained in our 2017 Annual Report.

## Critical accounting estimates

The preparation of the Company's consolidated financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. These estimates are based upon Management's historical experience and various other assumptions that are believed by Management to be reasonable under the circumstances.

Such assumptions and estimates are evaluated on an ongoing basis and form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates. The Company assesses the carrying value of its property, plant and equipment, intangible assets and goodwill every year, or more often if necessary. If it is determined that we cannot recover the carrying value of an asset or goodwill, the unrecoverable amount is written off against current earnings. The Company bases its assessment of recoverability on assumptions and judgments about future prices, demand and manufacturing costs. A material change in any of these assumptions could have a significant impact on the potential impairment and/or useful lives of these assets.

## Outstanding share data

Details of the Company's outstanding share data as of December 31, 2017, are as follows:

| | |
|---|---|
| 8,941,624 | Class A Shares |
| 2,778,300 | Class B Common Shares |
| 11,719,924 | Total Class A and B Shares |

There have been no material changes to the outstanding share data as of the date of this report.

## New accounting pronouncements

The International Accounting Standards Board has issued the following Standards, Interpretations and amendments to Standards that are not yet effective and while considered relevant to the Company, have not yet been adopted by the Company.

### Classification and Measurement of Share-Based Payment Transactions

On June 20, 2016, the IASB issued amendments to IFRS 2 Share-Based Payments clarifying how to account for certain types of share-based payment transactions. The amendments apply for annual periods beginning on or after January 1, 2017. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early, application is permitted if information is available without the use of hindsight.

The amendments provide requirements on the accounting for:

- The effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;
- Share-based payment transactions with a net settlement feature for withholding tax obligations; and
- A modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.

The Company intends to adopt the amendments to IFRS 2 in its consolidated financial statements for the annual period beginning on January 1, 2018. The Company does not expect the amendments to have a material impact on the consolidated financial statements.

### Revenue from contracts with customers

On May 28, 2014 the IASB issued IFRS 15, Revenue from Contracts with Customers. This new standard is effective for annual periods beginning on or after January 1, 2018.

IFRS 15 will replace IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC 31 Revenue – Barter Transactions Involving Advertising Services. On April 12, 2016, the IASB issued Clarification to IFRS 15, Revenue from Contracts with Customers, which is effective at the same time as IFRS 15.

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized.

New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The new standard applies to contracts with customers and is effective for fiscal years beginning on or after January 1, 2018. It does not apply to insurance contracts, financial instruments or lease contracts.

*Transition considerations*

IFRS 15 can be applied using one of the following two methods: retrospectively to each prior reporting period presented in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, or retrospectively with the cumulative effect of initially applying IFRS 15 recognized in opening retained earnings at the date of initial application (the "modified retrospective method"). The Company has decided to adopt IFRS 15 using the modified retrospective method, with recognition of transitional adjustments in retained earnings on the date of initial application (January 1, 2018), without restatement of comparative figures.

IFRS 15 provides for certain optional practical expedients, including upon the initial adoption of the standard. The Company intends to apply the following practical expedients upon adoption of IFRS 15 on January 1, 2018:

- Completed contracts - the Company will apply IFRS 15 retrospectively only to contracts that are not completed contracts as at January 1, 2018.
- Contract modifications - the Company will not apply IFRS 15 retrospectively to contract modifications that occurred before January 1, 2018.

*Quantification of impact*

The Company is currently finalizing the quantification of the impact of IFRS 15 on its consolidated financial statements. Management has reviewed the new standard against its existing account policies and practices, including reviewing standard purchase orders, invoices, shipping terms, and contracts with customers within its significant revenue streams in order to assess any terms that can represent additional performance obligations and to evaluate transaction price considerations. Currently, the Company recognizes revenue from the sale of goods, measured at the fair value of the consideration received or receivable, net of provisions for customer incentives and sales returns.

The majority of the Company's contracts with customers are contracts in which the sale of finished product is generally expected to be the only performance obligation. For these arrangements, the Company has concluded that the revenue recognition occurs at a point in time when control of the asset is transferred to the customer, generally upon shipment of products to customers, consistent with its current practice. The Company offers certain customer incentives which are available in the event qualifying customers achieve minimum purchase volumes. These programs are made available on a calendar year basis, such that at the end of each fiscal year, entitlements by customers to any incentives are known. Currently, the Company estimates the amount of incentives which will be payable to customers at each reporting date during the year, based on the specifics of the incentive program and historical and projected sales volumes. Such incentives represent variable consideration under IFRS 15, which is also estimated at contract inception.

The Company will adopt the new standard in the first quarter of fiscal 2018. The Company is completing the assessment of the overall impact on the Company's disclosures and is addressing any system, control, and process changes necessary to compile the information to meet the recognition and disclosure requirements for the new guidance starting in the first quarter of fiscal 2018.

**Financial instruments**

On July 24, 2014 the IASB issued the complete IFRS 9 Financial Instruments (IFRS 9 (2014)). The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight. IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship.

Special transitional requirements have been set for the application of the new general hedging model. The Company will adopt IFRS 9 (2014) in its consolidated financial statements for the annual period beginning on January 1, 2018.

Although the methodology related to the classification of financial instruments will change, the Company expects that most of its financial assets currently classified as "loans and receivables" and measured at amortized cost (approximately $75,714,000 as at December 31, 2017) will be classified as "financial assets subsequently measured at amortized cost."

Excluding the potential impact from the change in the impairment model applicable to these financial assets, which is currently being analyzed, the Company does not expect any significant impact on their measurement.

The Company is currently evaluating the impact of determining the amount of impairment of certain financial assets based on the expected credit loss model. While the Company had approximately $1,961,000 of allowance for doubtful accounts on its trade receivables as at December 31, 2017, most of this allowance was related to commercial reasons, such as balances being disputed or subject to negotiation, rather than credit risk.

Upon adoption of IFRS 9, the Company expects to apply the exemption from the requirement to restate comparative information. Therefore, differences between the previous carrying amounts and the carrying amounts at the date of initial application, if any, will be recognized in the opening balance of retained earnings or other components of equity, as appropriate, as at January 1, 2018.

The Company has assessed the impact of the change on its financial systems, internal controls and policies and procedures related to the adoption of IFRS 9 in 2018.

**Leases**

On January 13, 2016 the IASB issued IFRS 16 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities from all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Company intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of this standard has yet to be determined.

**Foreign Currency Transactions with Advance Consideration**

On December 8, 2016 the IASB issued IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consolidation. The Interpretation clarifies which date should be used for translation when a foreign currency transaction involves an advanced payment or receipt. The Interpretation is applicable for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Interpretation clarifies that the date of the transaction for the purposes of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

The Interpretation may be applied either:

- Retrospectively; or

- Prospectively to all assets, expenses and income in the scope of the Interpretation initially recognized on or after:
  - the beginning of the reporting period in which the entity first applies the Interpretation; or
  - the beginning of a prior reporting period presented as comparative information in the consolidated financial statements

The Company intends to adopt the Interpretation in its consolidated financial statements for the annual period beginning on January 1, 2018. The Company will apply the Interpretation prospectively to all assets, expenses and income initially recognized on or after January 1, 2018. The Company does not expect the Interpretation to have a material impact on the consolidated financial statements.

**Uncertainty over Income Tax Treatments**

On June 7, 2017 the IASB issued IFRIC Interpretation 23, Uncertainty over Income Tax Treatments. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances which there is uncertainty over income tax treatments. The Interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted.

The Interpretation requires:

- An entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better prediction of the resolution;
- An entity to determine if it is probable that the tax authorities will accept uncertain tax treatment; and
- If it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty.

The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

**Transfer of Assets between an Investor and its Associate or Joint Venture**

On September 11, 2014 the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28). The amendments were to be applied prospectively for annual periods beginning on or after January 1, 2016, however, on December 17, 2015 the IASB decided to defer the effective date for these amendments indefinitely. Adoption is still permitted.

The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture (JV). Specifically, under the existing consolidation standard the parent recognises the full gain on the loss of control, whereas under the existing guidance on associates and JVs, the parent recognises the gain only to the extent of unrelated investors' interests in the associate or JV.

HPS is positioned to meet the evolving needs of our traditional markets while becoming a leading player in a growing number of market sectors. Our drive, resilience, commitment, solid supplier relationships, 100 years of experience, engineering expertise and a broad and unique business perspective are all key factors to our future success. Our approach to growth has allowed us to continue to be an industry leader, remain financially and operationally strong and navigate through the enduring economic uncertainty and unrest.

We are confident in our future.

The main consequence of the amendments is that a full gain/loss is recognised when the assets transferred meet the definition of a 'business' under IFRS 3 Business Combinations. A partial gain/loss is recognized when the assets transferred do not meet the definition of a business, even if these assets are housed in a subsidiary.

The Company does not intend to adopt these amendments in its financial statements for the annual period beginning January 1, 2018, as the effective date for these amendments has been deferred indefinitely.

### Strategic direction and outlook

Hammond Power Solutions has a strong history and strength in perseverance and resilience. The Company has navigated through difficult and fluctuating economic times, increased globalization, adapted to changes in customers and markets and has experienced significant advances in technology. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes.

The Company is confronting these challenges and continuously building our strategic advantage by focusing on:

- Investing in capital and its employees;
- Disciplined cost management initiatives;
- Sales development;
- Broadened product offering;
- Bringing quality and value to all stakeholders of the Company;
- Identifying and pursuing additional sales opportunities with both existing as well as new customers;
- Cash flow generation;
- Product development; and
- Capital investment.

HPS is cognizant that the global economy is critical to ensuring competitiveness and market share growth. The International expansion into India and Italy has allowed the Company to expand product offerings and opened up additional markets and customers that were previously not accessible. These acquisitions also provided HPS with cast resin technology, which has introduced new markets.

The Company has modern manufacturing facilities throughout the world and this continues to be enhanced through our committed capital investment. The Mexico based joint venture, Corefficient, is evidence of investing in the future, in both technology and capacity, which enhances our competitiveness.

The implementation of the ERP system has allowed HPS to enhance the availability and quality of information accessible to support operational performance and strategic decision making. This system has been implemented in the majority of the North American facilities and is currently a project for the implementation in our Indian facility. This newest addition to the ERP platform is an important step towards providing one global, integrated, consistent source of information and data.

HPS continues to focus on customer service – expanding existing relationships as well as exploring

new opportunities. Our past requirement to comply with the U.S. Department of Energy regulations and the upcoming Canadian efficiency standard changes (NRCan) has created opportunities for the Company to deliver energy efficient, regulatory compliant transformers fulfilling the needs of our customers.

These regulation changes have resulted in new product development and manufacturing techniques.

While the Company has experienced a number of successes, the challenging global economic climate, as well as the variability of raw material commodity costs, fluctuating manufacturing throughput and market pricing pressures has impacted the Company. Through HPS' strategic projects and operational plans these deterrents are being prudently managed.

During 2017, HPS made the difficult decision to realign its cost structures. Two specific strategies were executed as part of the restructuring. The first, occurred in Quarter 1, 2017 – HPS made the difficult decision to reduce its people investment within North America. This reduction in staffing levels better positioned the Company's cost structure for the future, while ensuring that all vital activities and processes continue to operate efficiently while ensuring the stakeholders of the Company continue to receive a high level of service and quality product. The second strategy involved the sale of the VPI product line in Italy through an asset purchase agreement. The sale allowed HPS to reduce its excess capacity, decrease staffing costs, condense its asset investment, consolidate plants and increase its capacity utilization of its Italian operations.

HPS is positioned to meet the evolving needs of our traditional markets while becoming a leading player in a growing number of market sectors. Our drive, resilience, commitment, solid supplier relationships, 100 years of experience, engineering expertise and a broad and unique business perspective are all key factors to the future success for HPS. Our diverse products, loyal customers and targeted markets are critical to generating future sales growth.

HPS is committed to driving accountability – through revenue creation, market share growth, expense management, cash flow generation and overall profitability and strategic direction. We are firmly committed to delivering long-term value to our shareholders, escalating improvement in the Company's financial results and remaining focused on the success of all stakeholders of the company. The Company's approach to growth has allowed HPS to continue to be an industry leader, remain financially and operationally strong and navigate through the enduring economic uncertainty and unrest.

We are confident in our future.

# Selected Annual and Quarterly Information

(tabular amounts in thousands of dollars)

| Annual Information | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Sales | 242,941 | 247,756 | 274,639 | 274,793 | 301,750 |
| Earnings from operations | 11,036 | 6,460 | 12,644 | 10,873 | 14,470 |
| EBITDA | 16,924 | 12,327 | 18,748 | 14,356 | 19,633 |
| Net earnings | 6,104 | 2,520 | 6,320 | 1,793 | 6,114 |
| Total assets | 186,878 | 184,291 | 222,969 | 205,177 | 192,449 |
| Non-current liabilities | 10,220 | 9,527 | 5,454 | 4,131 | 3,442 |
| Total liabilities | 77,827 | 69,854 | 90,668 | 84,524 | 77,438 |
| Total shareholders' equity attributable to equity holders of the Company | 107,014 | 112,271 | 129,665 | 120,441 | 114,848 |
| Total debt | (21,104) | (14,833) | (13,202) | (11,318) | (16,983) |
| Cash provided by operations | 765 | 18,450 | 16,065 | 15,216 | 1,032 |
| Basic earnings per share | 0.52 | 0.22 | 0.53 | 0.16 | 0.53 |
| Diluted earnings per share | 0.52 | 0.22 | 0.53 | 0.16 | 0.52 |
| Dividends declared and paid | 2,328 | 2,800 | 2,807 | 2,808 | 2,809 |
| Average exchange rate (USD$=CAD$) | 1.029 | 1.1025 | 1.274 | 1.325 | 1.298 |
| Book value per share | 9.17 | 9.61 | 11.08 | 10.29 | 9.80 |

| | 2016 | | | | 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| Quarterly Information | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Sales | 68,722 | 69,138 | 62,860 | 74,073 | 72,362 | 78,874 | 74,685 | 75,829 |
| Earnings from operations | 2,677 | 2,560 | 1,003 | 4,633 | 2,405 | 4,953 | 3,338 | 3,774 |
| EBITDA | 3,787 | 3,601 | 1,858 | 5,110 | 3,902 | 6,273 | 4,903 | 4,555 |
| Net earnings | 884 | 517 | 99 | 293 | 1,084 | 2,842 | 1,563 | 625 |
| Total assets | 208,810 | 203,379 | 200,896 | 205,177 | 204,371 | 197,887 | 194,147 | 192,449 |
| Non-current liabilities | 5,740 | 5,663 | 5,241 | 4,131 | 4,549 | 4,291 | 4,198 | 3,442 |
| Total liabilities | 82,534 | 76,846 | 79,364 | 84,524 | 81,639 | 76,252 | 80,478 | 77,438 |
| Total shareholders' equity attributable to equity holders of the Company | 123,910 | 120,677 | 121,333 | 120,441 | 122,732 | 121,288 | 116,491 | 114,848 |
| Total debt | (21,515) | (31,217) | (26,640) | (11,318) | (21,475) | (20,416) | (16,407) | (16,983) |
| Cash (used) provided by operations | (3,380) | (4,941) | 6,282 | 17,255 | (7,622) | 2,315 | 5,918 | 421 |
| Basic earnings per share | 0.07 | 0.05 | 0.01 | 0.03 | 0.09 | 0.25 | 0.14 | 0.05 |
| Diluted earnings per share | 0.07 | 0.05 | 0.01 | 0.03 | 0.09 | 0.25 | 0.14 | 0.04 |
| Dividends declared and paid | 702 | 702 | 702 | 702 | 702 | 702 | 702 | 703 |
| Average exchange rate (USD$=CAD$) | 1.376 | 1.287 | 1.306 | 1.332 | 1.323 | 1.347 | 1.253 | 1.270 |
| Book value per share | 10.59 | 10.31 | 10.37 | 10.29 | 10.46 | 10.37 | 9.96 | 9.80 |

# Management's Responsibility for Financial Statements

The Consolidated Financial Statements are the responsibility of the management of Hammond Power Solutions Inc. These statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), using management's best estimates and judgments where appropriate.

Management is responsible for the reliability and integrity of the Consolidated Financial Statements, the Notes to Consolidated Financial Statements and other financial information contained in the report. In the preparation of these statements, estimates were sometimes necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgment and have been properly reflected in the accompanying Consolidated Financial Statements. Management is responsible for the maintenance of a system of internal controls designed to provide reasonable assurances that the assets are safeguarded and that accounting systems provide timely, accurate and reliable financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities through the Audit Committee of the Board, which is composed of all of the directors, of whom seven are non-management directors. The Audit Committee meets periodically with management and the auditors to satisfy itself that management's responsibilities are properly discharged, to review the Consolidated Financial Statements and to recommend approval of the Consolidated Financial Statements to the Board of Directors.

KPMG LLP, the independent auditors appointed by the shareholders, has audited the Company's Consolidated Financial Statements in accordance with Canadian generally accepted auditing standards, and their report follows. The independent auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings as to the integrity of the financial reporting process.

WGH

William G. Hammond
Chairman of the Board
& Chief Executive Officer

Christopher R. Huether
Corporate Secretary
& Chief Financial Officer

March 27, 2018

# To the Shareholders of Hammond Power Solutions

We have audited the accompanying consolidated financial statements of Hammond Power Solutions Inc., which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016, the consolidated statements of earnings, comprehensive income, changes in equity and cash flows for the years ended December 31, 2017 and December 31, 2016, and notes, comprising a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hammond Power Solutions Inc. as at December 31, 2017 and December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

March 27, 2018
Waterloo, Ontario

# Consolidated Statements of Financial Position

(in thousands of dollars)

| | | As at December 31, 2017 | | December 31, 2016 |
|---|---|---|---|---|
| Current assets | | | | |
| Cash and cash equivalents | $ | 10,772 | $ | 25,189 |
| Accounts receivable (note 4) | | 59,170 | | 49,969 |
| Inventories (note 5) | | 38,340 | | 41,163 |
| Income taxes receivable | | 1,701 | | 1,155 |
| Prepaid expenses and other assets (note 6) | | 3,419 | | 1,826 |
| Total current assets | | 113,402 | | 119,302 |
| Non-current assets | | | | |
| Long-term lease and note receivable (note 7) | | 4,605 | | – |
| Property, plant and equipment (note 8) | | 32,276 | | 40,510 |
| Investment in properties (note 9) | | 1,044 | | 1,044 |
| Investment in joint venture (note 10) | | 12,158 | | 13,272 |
| Deferred tax assets (note 15) | | 776 | | 1,548 |
| Intangible assets (note 11) | | 11,166 | | 12,281 |
| Goodwill (notes 11 and 12) | | 17,022 | | 17,220 |
| Total non-current assets | | 79,047 | | 85,875 |
| **Total assets** | $ | 192,449 | $ | 205,177 |
| **Liabilities** | | | | |
| Current liabilities | | | | |
| Bank operating lines of credit (note 13) | $ | 27,755 | $ | 36,507 |
| Accounts payable and accrued liabilities (note 19 and 25) | | 45,647 | | 42,789 |
| Income tax liabilities | | 137 | | 557 |
| Provisions (note 20) | | 457 | | 540 |
| Total current liabilities | $ | 73,996 | $ | 80,393 |
| **Non-current liabilities** | | | | |
| Provisions (note 20) | | 100 | | 100 |
| Deferred tax liabilities (note 15) | | 3,342 | | 4,031 |
| Total non-current liabilities | | 3,442 | | 4,131 |
| **Total liabilities** | $ | 77,438 | $ | 84,524 |
| **Shareholders' Equity** | | | | |
| Share capital (note 16) | | 13,986 | | 13,843 |
| Contributed surplus | | 2,600 | | 2,605 |
| Accumulated other comprehensive income | | 1,916 | | 10,992 |
| Retained earnings | | 96,346 | | 93,001 |
| Total shareholders' equity attributable to equity holders of the Company | $ | 114,848 | $ | 120,441 |
| Non-controlling interests | | 163 | | 212 |
| **Total shareholder's equity** | | 115,011 | | 120,653 |
| Commitments and contingencies (note 14) | | | | |
| Subsequent events (note 29) | | | | |
| **Total liabilities and shareholders' equity** | $ | 192,449 | $ | 205,177 |

See accompanying Notes to Consolidated Financial Statements.

On behalf of the Board:

William G. Hammond
Chairman of the Board & Chief Executive Officer

David J. FitzGibbon
Chairman Audit Committee

# Consolidated Statements of Earnings

Years ended December 31, 2017 and 2016 (in thousands of dollars, except for per share amount)

| | | **2017** | | 2016 |
|---|---|---|---|---|
| Sales | $ | 301,750 | $ | 274,793 |
| Cost of sales (note 5) | | 227,346 | | 207,883 |
| Gross margin | | 74,404 | | 66,910 |
| Selling and distribution | | 34,120 | | 29,886 |
| General and administrative | | 24,428 | | 24,734 |
| Restructuring charges (note 21) | | 1,386 | | – |
| Impairment of goodwill (note 11 and 12) | | – | | 1,417 |
| Earnings from operations | | 14,470 | | 10,873 |
| **Finance and other costs** | | | | |
| Interest expense | | 1,263 | | 1,067 |
| Foreign exchange (gain) loss | | (137) | | 844 |
| Share of loss of investment in joint venture net of tax (note 10) | | 530 | | 2,400 |
| Loss on disposition (note 7) | | 1,022 | | – |
| Other | | (53) | | 106 |
| Net finance and other costs | | 2,625 | | 4,417 |
| **Earnings before income taxes** | | 11,845 | | 6,456 |
| Income tax expense (recovery) (note 15): | | | | |
| Current | | 5,734 | | 5,392 |
| Deferred | | (3) | | (729) |
| | | 5,731 | | 4,663 |
| Net earnings | $ | 6,114 | $ | 1,793 |
| Net loss attributable to non-controlling interest | | (40) | | (30) |
| Net earnings attributable to the equity holders of the Company | | 6,154 | | 1,823 |
| Net earnings | $ | 6,114 | $ | 1,793 |
| **Earnings per share (note 17)** | | | | |
| Basic earnings per share | $ | 0.53 | $ | 0.16 |
| Diluted earnings per share | $ | 0.52 | $ | 0.16 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Comprehensive Income

Years ended December 31, 2017 and 2016 (in thousands of dollars)

| | **2017** | 2016 |
|---|---|---|
| Net earnings | $ 6,114 | $ 1,793 |
| **Other comprehensive income** | | |
| Item that will be recognized within profit and loss: | | |
| Foreign currency translation differences for foreign operations | (9,085) | (7,478) |
| Other comprehensive loss for the period, net of income tax | (9,085) | (7,478) |
| Total comprehensive loss for the period | $ (2,971) | $ (5,685) |
| Total comprehensive loss attributable to equity holders of the Company | (2,922) | (5,552) |
| Total comprehensive loss attributable to non-controlling interest | (49) | (133) |
| | $ (2,971) | $ (5,685) |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Changes in Equity

Years ended December 31, 2017 and 2016 (in thousands of dollars)

| | SHARE CAPITAL | CONTRIBUTED SURPLUS | AOCI* | RETAINED EARNINGS | NON-CONTROLLING INTEREST | TOTAL SHAREHOLDERS' EQUITY |
|---|---|---|---|---|---|---|
| Balance as at January 1, 2016 | $ 13,843 | $ 2,434 | $ 18,492 | $ 94,896 | $ 2,636 | $ 132,301 |
| **Total comprehensive (loss) income for the period** | | | | | | |
| Net earnings (loss) | – | – | – | 1,823 | (30) | 1,793 |
| **Other comprehensive loss** | | | | | | |
| Foreign currency translation differences related to joint venture (note 10) | – | – | (2,158) | – | – | (2,158) |
| Foreign currency translation differences | – | – | (5,217) | – | (103) | (5,320) |
| Total other comprehensive loss | – | – | (7,375) | – | (103) | (7,478) |
| Total comprehensive loss for the period | – | – | (7,375) | 1,823 | (133) | (5,685) |
| **Transactions with owners, recorded directly in equity** | | | | | | |
| Non-controlling interest (note 18) | – | – | (125) | (910) | (2,291) | (3,326) |
| Dividends to equity holders (note 16) | – | – | – | (2,808) | – | (2,808) |
| Share-based payment transactions (note 16) | – | 171 | – | – | – | 171 |
| Total transactions with owners | – | 171 | (125) | (3,178) | (2,291) | (5,963) |
| **Balance at December 31, 2016** | $ 13,843 | $ 2,605 | $ 10,992 | $ 93,001 | $ 212 | $ 120,653 |
| **Total comprehensive income (loss) for the period** | | | | | | |
| Net earnings (loss) | – | – | – | 6,154 | (40) | 6,114 |
| **Other comprehensive loss** | | | | | | |
| Foreign currency translation differences related to the joint venture (note 9) | – | – | (1,210) | – | – | (1,210) |
| Foreign currency translation differences | – | – | (7,866) | – | (9) | (7,875) |
| Total other comprehensive loss | – | – | (9,076) | – | (9) | (9,085) |
| Total comprehensive loss for the period | – | – | (9,076) | 6,154 | (49) | (2,971) |
| **Transactions with owners, recorded directly in equity** | | | | | | |
| Dividends to equity holders (note 16) | – | – | – | (2,809) | – | (2,809) |
| Stock options exercised (note 16) | 143 | (19) | – | – | – | 124 |
| Share-based payment transactions (note 16) | – | 14 | – | – | – | 14 |
| Total transactions with owners | 143 | (5) | – | (2,809) | – | (2,671) |
| **Balance at December 31, 2017** | $ 13,986 | $ 2,600 | $ 1 ,916 | $ 96,346 | $ 163 | $ 115,011 |

*AOCI – Accumulated other comprehensive income
See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

Years ended December 31, 2017 and 2016 (in thousands of dollars)

| | 2017 | 2016 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net earnings | $ 6,114 | $ 1,793 |
| Adjustments for: | | |
| Impairment of goodwill (note 11 and 12) | – | 1,417 |
| Share of loss of investment in joint venture | 530 | 2,400 |
| Depreciation of property, plant and equipment | 5,100 | 5,438 |
| Amortization of intangible assets | 1,425 | 1,395 |
| Provisions | (83) | 34 |
| Interest expense | 1,263 | 1,067 |
| Loss on disposition | 1,022 | 10 |
| Income tax expense | 5,731 | 4,663 |
| Unrealized gain on derivatives | 331 | 104 |
| Payment of accrued pension benefit obligation | – | (389) |
| Share-based compensation expense | 14 | 171 |
| | 21,447 | 18,103 |
| Change in non-cash working capital (note 24) | (13,715) | 4,801 |
| Cash generated from operating activities | 7,732 | 22,904 |
| Income tax paid | (6,700) | (7,688) |
| Net cash provided from operating activities | 1,032 | 15,216 |
| **Cash flows from investing activities** | | |
| Investment in joint venture (note 10) | (626) | (4,580) |
| Purchase of non-controlling interest (note 18) | – | (3,326) |
| Proceeds on disposal of property, plant and equipment | 33 | 210 |
| Repayment of note receivable | 75 | – |
| Acquisition of property, plant and equipment | (2,319) | (2,164) |
| Acquisition of intangible assets | (128) | (281) |
| Cash used in investing activities | (2,965) | (10,141) |
| **Cash flows from financing activities** | | |
| Proceeds from issue of share capital | 124 | – |
| Cash dividends paid | (2,809) | (2,808) |
| (Repayment) advances of bank operating lines of credit | (8,752) | 7,341 |
| Repayment of long-term debt | – | (3,929) |
| Interest paid | (1,263) | (1,067) |
| Cash used in financing activities | (12,700) | (463) |
| Foreign exchange on cash and cash equivalents held in a foreign currency | 216 | 586 |
| (Decrease) increase in cash and cash equivalents | (14,417) | 5,198 |
| Cash and cash equivalents at beginning of period | 25,189 | 19,991 |
| **Cash and cash equivalents at end of period** | $ 10,772 | $ 25,189 |

See accompanying Notes to Consolidated Financial Statements.

## 1. Reporting entity

Hammond Power Solutions Inc. ("HPS" or "the Company") is a corporation domiciled in Canada. The address of the Company's registered office is 595 Southgate Drive, Guelph, Ontario. The Company's Class A subordinate voting shares are listed on the Toronto Stock Exchange and trade under the symbol HPS.A.

The consolidated financial statements of the Company comprise the Company and its subsidiaries (together referred to as the "Group" and individually as "Group entities"). The Group primarily is involved in the design and manufacture of custom electrical magnetics, cast resin, custom liquid filled distribution and power transformers and standard electrical transformers, serving the electrical and electronic industries. The Group has manufacturing plants in Canada the United States ("U.S."), Mexico, Italy and India, the latter being Hammond Power Solutions Private Limited, a subsidiary in which the Company holds an 85% equity ownership. The Company also holds a 55% economic interest in a joint venture located in Mexico called Corefficient de R.L. de C.V. ("Corefficient").

## 2. Basis of preparation

### (a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), and were approved by the Board of Directors on March 27, 2018.

### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for inventories carried at net realizable value, derivative financial instruments and share based payments which are measured at fair value, and the initial present value of finance leases receivable which are determined using cash flows implicit in the lease and a discount rate reflecting the interest rate implicit in the lease.

### (c) Functional and presentation currency

The functional currency of the Group's entities is the currency of their primary economic environment.

In individual companies, transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities in foreign currencies at the reporting date are re-measured to the functional currency at the exchange rate at that date. Any resulting exchange differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

On consolidation, assets and liabilities of Group entities reported in their functional currencies are translated into the Canadian dollar, being the presentation currency, at the exchange rate on the reporting date. The income and expenses of foreign operations are translated to Canadian dollars using average exchange rates for the month during which the transactions occurred. Foreign currency differences are recognized in other comprehensive income in the cumulative translation account within accumulated other comprehensive income.

The functional currency of the Company's Canadian operations and its subsidiaries are as follows:

| Canadian & Subsidiary Operations | Functional Currency | |
|---|---|---|
| Canada | Canadian dollar | ($ CAD) |
| United States | U.S. dollar | ($ USD) |
| Mexico | Mexican Peso | (Pesos) |
| Mexico – Corefficient (1) | U.S. dollar | ($ USD) |
| Italy | Euro | (EUR €) |
| India | Rupee | (INR) |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

[1] Group management regularly evaluates whether events and conditions indicate that a Group entity's functional currency has changed. During 2017, as Corefficient's business model has begun to achieve maturity, Group management performed a detailed analysis of primary and secondary indicators of functional currency in accordance with IAS 21, "The Effects of Changes in Foreign Exchange Rates", and concluded that the functional currency changed from the Mexican peso (MXP) to the United States dollar (USD) beginning January 1, 2017.

**(d) Use of estimates and judgments**

The preparation of the consolidated financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

**(i) Critical judgments in applying accounting policies**

The following are the critical judgments, apart from those involving estimations, that Management has made in the process of applying the Group's accounting policies and that have the most significant effects on the amounts recognized in the consolidated financial statements.

**Cash generating units**

As indicated in note 3(h) and 3(l); the Group conducts its impairment tests at the individual asset level or, where the recoverable amount cannot be determined for an individual asset, or for goodwill, at the cash generating unit (CGU) level. The Group defines its CGUs based on the way it monitors and derives economic benefits from the acquired goodwill and intangibles. A cash-generating unit is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The identification of a cash-generating unit involves judgment.

**Operating segments**

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. The determination of operating segments involves judgment. Management has determined that the Group operates as a single operating segment, being the design, manufacture and sale of transformers.

**(ii) Key sources of estimation uncertainty**

The following are the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the consolidated financial statements within the next twelve months.

**Goodwill**

The Group tests annually or more frequently if necessary, whether goodwill has suffered any impairment in accordance with the accounting policy provided in note 3(h). Performing goodwill impairment testing requires management to determine the estimated recoverable amount of the relevant cash-generating units on the basis of projected future cash flows using internal business plans or forecasts, and discounting these cash flows to appropriately reflect the time value of money. While management believes that estimates of future cash flows and discount rates are reasonable, different assumptions regarding future cash flows or discount rates could materially affect the outcome of the goodwill impairment test. For assumptions relating to goodwill impairment testing, refer to note 12.

## 3. Summary of significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and by all Group entities.

### (a) Basis of consolidation

The consolidated financial statements include the accounts of Hammond Power Solutions Inc. and its wholly-owned subsidiaries, Hammond Power Solutions, Inc., Hammond Power Solutions, S.A. de C.V., Delta Transformers Inc., Continental Transformers s.r.l., and its wholly-owned subsidiary, HPS S.p.A., and an 85% owned subsidiary Hammond Power Solutions Private Limited (previously known as PETE-Hammond Power Solutions Private Limited and Pan-Electro Technic Enterprises Private Limited).

Joint operations arise from an arrangement in which the interested parties are bound by a contract which gives two or more parties joint control of the arrangement, and those parties have rights to the assets and obligations for the liabilities relating to the arrangement. The Company has a 50% interest in Glen Ewing Properties, an unincorporated co-tenancy. The consolidated financial statements include the Group's share of the entity's assets, liabilities, revenue and expenses with items of a similar nature on a line-by-line basis.

Joint ventures arise in which the interested parties are bound by a contract which gives two or more parties joint control of the arrangement, and those parties have rights to the net assets of the arrangement. The Company's interest in Corefficient is considered to represent a joint venture. Interests in joint ventures are initially recognized at cost. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and other comprehensive income.

All significant inter-company transactions and balances have been eliminated.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling interest's share of changes in equity since the date of the combination.

### (b) Financial instruments

The Group aggregates its financial instruments into classes based on their nature and characteristics. The Group has classified its financial instruments as follows:

- Cash and cash equivalents, accounts receivable, and long-term lease and note receivable are classified as loans and receivables;
- Bank operating lines of credit and accounts payable and accrued liabilities are classified as other liabilities; and
- Derivative financial instruments are classified as fair value through profit or loss.

### (c) Financial assets and financial liabilities

Financial assets and financial liabilities are initially recognized at fair value plus directly attributable transaction costs, unless the transaction costs relate to financial instruments classified as fair value through profit and loss, in which case they are expensed immediately. Subsequent measurement is determined based on initial classification.

The Group uses trade date accounting for regular-way purchases and sales of financial assets.

#### (i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category includes cash and cash equivalents and accounts receivable.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method less appropriate allowances for doubtful receivables.

Allowances for doubtful receivables represent the Group's estimates of losses that could arise from the failure

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or inability of customers to make payments when due and is calculated as the difference between the carrying amount of the account receivable and the present value of the associated future cash flows. Where it becomes apparent that the account receivable will not be collected, the allowance for doubtful receivables is released and the account receivable written off.

**(ii) Other liabilities**

This category includes bank operating lines of credit and accounts payable and accrued liabilities. Subsequent to initial measurement, other liabilities are carried at amortized cost using the effective interest rate method.

**(iii) Fair value through profit or loss**

A financial instrument is classified as fair value through profit or loss if it is classified as held for trading or is designated as such on initial recognition. This category includes derivative financial instruments.

**(iv) Derivative financial instruments**

From time to time, the Group is party to derivative financial instruments in the form of forward foreign exchange contracts used to hedge foreign currency exposure arising on an intercompany loan. The Company also monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by entering into forward foreign exchange contracts. The Group records all of its forward contracts at fair value, with changes in fair value recognized through finance costs in the consolidated statement of earnings.

**(v) Fair value**

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties that are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques that refer to observable market data.

**(d) Cash and cash equivalents**

Cash and cash equivalents include cash and short-term deposits with maturities of three months or less.

**(e) Property, plant and equipment**

Property, plant and equipment are shown in the statement of financial position at their historical cost. Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and borrowing costs on qualifying assets for which the commencement date for capitalization is on or after January 1, 2010. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Depreciation is provided on components that have homogenous useful lives by using the straight-line method so as to depreciate the initial cost down to the residual value over the estimated useful lives.

The estimated useful lives for the current and comparative periods are as follows:

- Buildings 14-30 years
- Leaseholds and improvements lesser of 5 years and lease term

- Machinery and equipment 4-10 years
- Office equipment 4-10 years
- Land is not depreciated

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

Assets included in construction-in-progress are not depreciated until the assets are available for use. Idle assets that are available for use are depreciated.

**(f) Intangible assets other than goodwill**

Intangible assets that are acquired either separately or in a business combination are recognized when they are identifiable and can be reliably measured. Intangible assets are considered to be identifiable if they arise from contractual or other rights, or if they are separable (i.e. they can be disposed of either individually or together with other assets). Intangible assets comprise finite life intangible assets.

Finite life intangible assets are those for which there is an expectation of obsolescence that limits their useful economic life or where the useful life is limited by contractual or other terms. They are amortized over the shorter of their contractual or useful economical lives.

The estimated useful lives for the current and comparative periods are as follows:

- Customer lists and relationships 15 years
- Technology 20 years
- Software and other 4 years
- Branding 5 years

Amortization methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

**(g) Research and development expenses**

Research expenses are recognized as expenses in the financial period incurred.

Development expenses are recognized as an intangible asset if the Group can demonstrate the technical feasibility of making the intangible asset ready for commissioning or sale; its intention to complete the intangible asset and use or sell it; its ability to use or sell the intangible asset; how the intangible asset will generate future economic benefits; the availability of the appropriate resources (technical, financial or other) to complete development and use or sell the intangible asset; and its ability to provide a reliable estimate of expenses attributable to the intangible asset during its development.

**(h) Goodwill**

Acquisitions occurring on or after January 1, 2010, are accounted for using the acquisition method required by IFRS 3. Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amount allocated to the identifiable assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company's cash generating units that are expected to benefit from the synergies of the business combination.

The Company elects on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognized amount of the identifiable net assets, at the acquisition date.

Goodwill is tested for impairment at least annually and upon the occurrence of an indication of impairment.

The impairment tests are performed at the cash generating unit (CGU) level. The Group defines its CGUs based on the way it monitors and derives economic benefits from the acquired goodwill and intangibles. The impairment tests are performed by comparing the carrying value of the assets of these CGUs with the greater of its value in use and its fair value, less cost of disposal. The value in use is based on their future projected cash flows discounted to the present value at an appropriate pre-tax discount rate. The cash flows correspond to estimates made by Group Management in financial and strategic business plans covering a period of five years. They are then projected beyond five years using a steady or declining growth rate given that the Group businesses are of a long-term nature. The Group assesses the uncertainty of these estimates by making sensitivity analyses. The discount rate used approximates the CGU's weighted average cost of capital. The business risk is included in the determination of the cash flows.

An impairment loss in respect of goodwill is never subsequently reversed. The Group completed its annual goodwill impairment tests at December 31, 2017.

**(i) Investment property**

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business use in the production or supply of goods or services or for administrative purposes. The Group measures its investment property, being the property held by Glen Ewing Properties, at historical cost.

**(j) Joint Venture**

The Company applies the equity method of accounting for its investment in the joint venture. Under the equity method of accounting, interests in joint ventures are initially recognized in the Consolidated Statements of Financial Position at initial cost and adjusted thereafter to recognize the Group's share of the post-acquisition profits or losses and movements in other comprehensive income in the income statement and in other comprehensive income respectively. When the Group's share of losses in a joint venture equals or exceeds its interest in the joint venture, the Group does not recognize further losses unless it has incurred obligations or made payments on behalf of the joint venture.

Unrealized gains or transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture. Unrealized losses are also eliminated unless the transaction provides evidence of impairment of the assets transferred.

**(k) Inventories**

Inventories are valued at the lower of cost and net realizable value.

The cost of inventories is based on the first-in first-out principle and includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

When circumstances which previously caused inventories to be written down to their net realizable value no longer exist, the previous impairment is reversed.

**(l) Impairment of property, plant and equipment and finite life intangible assets**

The Group periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. Consideration is given at each Statement of Financial Position date to determine whether there is any indication of impairment of the carrying amounts of the Group's property, plant and equipment and finite life intangible assets. The Group reviews for impairment of long-lived assets, or asset groups, held and used whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

The recoverable amount is the greater of the fair value less cost of disposal and value in use. If the recoverable amount cannot be determined for one individual asset, the Group conducts its impairment test at the CGU level. In assessing value in use, the estimated future cash flows are discounted to their present value, based on the time value of money and the risks specific to the country where the assets are located. Assets that suffer impairment are assessed for possible reversal of the impairment at each reporting date.

**(m) Share-based payment transactions**

**Stock Option Plan**

The Group has a stock-based compensation plan, which is described in note 16. The Group accounts for all stock-based payments using the fair value based method.

Under the fair value based method, compensation cost for stock options and direct awards of stock is measured at fair value at the grant date. Compensation cost is recognized in earnings on a straight-line basis over the relevant vesting period, with a corresponding amount recorded in contributed surplus. The amount recognized as an expense, is adjusted to reflect the number of awards for which the related services are expected to be met. Upon exercise of a stock option, share capital is recorded at the sum of the proceeds received and the related amount of contributed surplus.

**Deferred Share Unit Plan**

The Company implemented a deferred share unit plan (the "DSU Plan") for its senior-executive management and Directors. Under the DSU Plan, participants may elect to defer compensation and receive DSUs equal to the value of the deferred compensation. DSUs are increased by the dividend rate on a quarterly basis.

Under IFRS, DSUs are classified as cash-settled share-based payment transactions as the participants shall receive cash following a Redemption Event. The DSUs do not contain any vesting conditions or forfeiture provisions, as they are issued in exchange for deferred compensation. As such, the Group recognizes the expense and the liability to pay for eventual redemption when the DSUs are issued. Thereafter, the Company re-measures the fair-value of the liability at the end of each reporting date and the date of settlement, with the difference recognized in income or expense for the period. The fair value of DSUs is determined in accordance with the DSU Plan, which uses the average closing price for HPS shares for the five trading days immediately preceding the relevant date. The DSU liability is included in accrued liabilities.

**(n) Provisions**

Provisions comprise liabilities of uncertain timing or amounts that arise from restructuring plans, environmental, litigation, commercial or other risks. Provisions are recognized when there exists a legal or constructive obligation stemming from a past event and when the future cash outflows can be reliably estimated. A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities.

**(o) Revenue**

The Group recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable.

**(p) Income taxes**

Income tax expense comprises current and deferred tax. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years. Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted at the reporting date.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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**(q) Employee benefits**

The Group maintains a defined contribution and a defined benefit plan, which are described in note 19 and have short-term employee benefits.

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans, are recognized as an employee benefit expense in profit or loss in the periods in which services are rendered by employees.

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of its defined benefit plan is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. The fair value of the plan assets are deducted. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed annually by a qualified actuary using the projected unit credit method.

When the benefits of the plan are improved, the portion of the increased benefit relating to past service by employees is recognized in profit or loss immediately. The Group recognizes all actuarial gains and losses arising from the defined benefit plan immediately in other comprehensive income, and reports them in retained earnings.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

**(r) Finance income and finance costs**

Finance income and finance costs comprise interest income, interest expense on borrowings, changes in fair value of financial instruments measured at fair value through profit and loss, foreign currency losses and other finance costs.

Foreign currency gains and losses are reported on a net basis.

**(s) Earnings per share**

The Group presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing net earnings of the Group by the weighted average number of common shares outstanding during the reporting period. Diluted EPS are computed similar to basic EPS except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that proceeds from such exercises along with any unamortized stock-based compensation were used to acquire common shares at the average market price during the year.

**(t) New accounting pronouncements adopted during the period**

**IAS 7 Statement of Cash Flows**

In January 2016, the IASB published amendments to IAS 7, Statement of Cash Flows. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. They are effective for annual periods beginning on or after January 1, 2017, with earlier application being permitted.

As a result of these amendments, the Limited Partnership is required to provide additional disclosure relating to financing activities, including a reconciliation between the beginning and closing balances of financial liabilities arising from financing activities. Refer to note 26.

**Recognition of Deferred Tax Assets for Unrealized Losses**

On January 19, 2016 the IASB issued Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to IAS 12). The amendments apply retrospectively for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The amendments clarify that the existence of a deductible temporary difference, depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences. The Group adopted the amendments to IAS 12 in its consolidated financial statements for the annual period beginning on January 1, 2017. The adoption of the amendment did not have a material impact on the consolidated financial statements.

**(u) New accounting pronouncements**

The International Accounting Standards Board has issued the following Standards, Interpretations and Amendments to Standards that are not yet effective and while considered relevant to the Group have not yet been adopted by the Group.

**Classification and Measurement of Share-Based Payment Transactions**

On June 20, 2016 the IASB issued amendments to IFRS 2 Share-Based Payments clarifying how to account for certain types of share-based payment transactions. The amendments apply for annual periods beginning on or after January 1, 2017. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early application is permitted if information is available without the use of hindsight.

The amendments provide requirements on the accounting for:

- The effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;
- Share-based payment transactions with a net settlement feature for withholding tax obligations; and
- A modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.

The Group intends to adopt the amendments to IFRS 2 in its consolidated financial statements for the annual period beginning on January 1, 2018. The Group does not expect the amendments to have a material impact on the consolidated financial statements.

**Revenue from contracts with customers**

On May 28, 2014 the IASB issued IFRS 15, Revenue from Contracts with Customers. This new standard is effective for annual periods beginning on or after January 1, 2018. IFRS 15 will replace IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC 31 Revenue – Barter Transactions Involving Advertising Services. On April 12, 2016 the IASB issued Clarification to IFRS 15, Revenue from Contracts with Customers, which is effective at the same time as IFRS 15.

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The new standard applies to contracts with customers and is effective for fiscal years beginning on or after January 1, 2018. It does not apply to insurance contracts, financial instruments or lease contracts.

*Transition considerations*

IFRS 15 can be applied using one of the following two methods: retrospectively to each prior reporting period presented in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, or retrospectively with the cumulative effect of initially applying IFRS 15 recognized in opening retained earnings at the date of initial application (the "modified retrospective method"). The Group decided to adopt IFRS 15 using the modified retrospective method, with recognition of transitional adjustments in retained earnings on the date of initial application (January 1, 2018), without restatement of comparative figures.

IFRS 15 provides for certain optional practical expedients, including upon the initial adoption of the standard. The Group intends to apply the following practical expedients upon adoption of IFRS 15 on January 1, 2018:

- Completed contract - the Group will apply IFRS 15 retrospectively only to contracts that are not completed contracts as at January 1, 2018.
- Contract modifications - the Group will not apply IFRS 15 retrospectively to contract modifications that occurred before January 1, 2018.

*Quantification of impact*

The Company is currently finalizing the quantification of the impact of IFRS 15 on its consolidated financial statements. Management has reviewed the new standard against its existing account policies and practices, including reviewing standard purchase orders, invoices, shipping terms, and contracts with customers within its significant revenue streams in order to assess any terms that can represent additional performance obligations and to evaluate transaction price considerations. Currently, the Company recognizes revenue from the sale of goods, measured at the fair value of the consideration received or receivable, net of provisions for customer incentives and sales returns.

The majority of the Company's contracts with customers are contracts in which the sale of finished product is generally expected to be the only performance obligation. For these arrangements, the Group has concluded that the revenue recognition occurs at a point in time when control of the asset is transferred to the customer, generally upon shipment of products to customers, consistent with its current practice. The Company offers certain customer incentives which are available in the event qualifying customers achieve minimum purchase volumes. These programs are made available on a calendar year basis, such that at end of each fiscal year, entitlements by customers to any incentives are known. Currently, the Company estimates the amount of incentives which will be payable to customers at each reporting date during the year, based on the specifics of the incentive program, and historical and projected sales volumes. Such incentives represent variable consideration under IFRS 15, which is also estimated at contract inception.

The Group will adopt the new standard in the first quarter of fiscal 2018. The Group is completing the assessment of the overall impact on the Company's disclosures and is addressing any system, control, and process changes necessary to compile the information to meet the recognition and disclosure requirements for the new guidance starting in the first quarter of fiscal 2018.

**Financial instruments**

On July 24, 2014 the IASB issued the complete IFRS 9 Financial Instruments (IFRS 9 (2014)). The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight. IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model. The Group will adopt IFRS 9 (2014) in its consolidated financial statements for the annual period beginning on January 1, 2018.

Although the methodology related to the classification of financial instruments will change, the Group expects that most of its financial assets currently classified as "loans and receivables" and measured at amortized cost (approximately $75,714,000 as at December 31, 2017) will be classified as "financial assets subsequently measured at amortized cost."

Excluding the potential impact from the change in the impairment model applicable to these financial assets, which is currently being analyzed, the Group does not expect any significant impact on their measurement.

The Group is currently evaluating the impact of determining the amount of impairment of certain financial assets based on the expected credit loss model. While the Company had approximately $1,961,000 of allowance for doubtful accounts on its trade receivables as at December 31, 2017, most of this allowance was related to commercial reasons, such as balances being disputed or subject to negotiation, rather than credit risk.

Upon adoption of IFRS 9, the Company expects to apply the exemption from the requirement to restate comparative information. Therefore, differences between the previous carrying amounts and the carrying amounts at the date of initial application, if any, will be recognized in the opening balance of retained earnings or other components of equity, as appropriate, as at January 1, 2018.

The Company has assessed the impact of the change on its financial systems, internal controls and policies and procedures related to the adoption of IFRS 9 in 2018.

**Leases**

On January 13, 2016 the IASB issued IFRS 16 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities from all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Group intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of this standard has yet to be determined.

**Foreign Currency Transactions with Advance Consideration**

On December 8, 2016 the IASB issued IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consolidation. The Interpretation clarifies which date should be used for translation when a foreign currency transaction involves an advanced payment or receipt. The Interpretation is applicable for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Interpretation clarifies that the date of the transaction for the purposes of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

The Interpretation may be applied either:

- Retrospectively; or
- Prospectively to all assets, expenses and income in the scope of the Interpretation initially recognized on or after:
  - the beginning of the reporting period in which the entity first applies the Interpretation; or
  - the beginning of a prior reporting period presented as comparative information in the consolidated financial statements.

The Group intends to adopt the Interpretation in its consolidated financial statements for the annual period beginning on January 1, 2018. The Group will apply the Interpretation prospectively to all assets, expenses and income initially recognized on or after January 1, 2018. The Group does not expect the Interpretation to have a material impact on the consolidated financial statements.

**Uncertainty over Income Tax Treatments**

On June 7, 2017 the IASB issued IFRIC Interpretation 23, Uncertainty over Income Tax Treatments. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances which there is uncertainty over income tax treatments. The Interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted.

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The Interpretation requires:

- An entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better prediction of the resolution;
- An entity to determine if it is probable that the tax authorities will accept uncertain tax treatment; and
- If it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty.

The Group intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

**Transfer of Assets between an Investor and its Associate or Joint Venture**

On September 11, 2014 the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28). The amendments were to be applied prospectively for annual periods beginning on or after January 1, 2016, however, on December 17, 2015 the IASB decided to defer the effective date for these amendments indefinitely. Adoption is still permitted.

The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture (JV). Specifically, under the existing consolidation standard the parent recognises the full gain on the loss of control, whereas under the existing guidance on associates and JVs the parent recognises the gain only to the extent of unrelated investors' interests in the associate or JV.

The main consequence of the amendments is that a full gain/loss is recognised when the assets transferred meet the definition of a 'business' under IFRS 3 Business Combinations. A partial gain/loss is recognized when the assets transferred do not meet the definition of a business, even if these assets are housed in a subsidiary.

The Group does not intend to adopt these amendments in its financial statements for the annual period beginning January 1, 2017, as the effective date for these amendments has been deferred indefinitely.

## 4. Accounts receivable

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Trade accounts receivable | $ 54,236 | $ 45,945 |
| Other receivables | 4,934 | 4,024 |
| | $ 59,170 | $ 49,969 |

Trade accounts receivable is presented net of an allowance for doubtful accounts of $1,961,000 (December 31, 2016 - $1,127,000).

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Opening balance | $ 1,127 | $ 1,525 |
| Additional allowances | 1,080 | 40 |
| Writeoffs | (393) | (257) |
| Adjustments | 147 | (181) |
| | $ 1,961 | $ 1,127 |

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## 5. Inventories

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Raw materials | $ 18,237 | $ 18,890 |
| Work in progress | 2,974 | 3,072 |
| Finished goods | 17,129 | 19,201 |
| | $ 38,340 | $ 41,163 |

Raw materials and changes in finished goods, and work in progress recognized as cost of sales during the year amounted to $226,090,000 (2016 – $206,658,000). In addition, during the year, a reversal of previous write-downs in the amount of $46,000 was recognized (2016 – write-down of $6,000). Inventories carried at net realisable value as at December 31, 2017 were $341,000 (December 31, 2016 – $825,000).

## 6. Prepaid and other assets

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Prepaid expenses | $ 2,252 | $ 1,787 |
| Derivative assets | – | 39 |
| Current portion of long-term lease and note receievable (note 7) | 1,167 | – |
| | $ 3,419 | $ 1,826 |

## 7. Long-term lease and note receivable and disposal of VPI product line

On October 31, 2017, the Group sold the assets and disposed of certain liabilities of its Vacuum Pressure Impregnated (VPI) transformers product line located in Italy. Consideration due to the Group in connection with the transaction includes a note receivable in the amount of 1,288,000 Euros (approximately $1,938,000 Canadian dollars). Concurrent with the disposal of the VPI product line, the Group entered into a lease agreement for one of its manufacturing facilities in Italy, under which the purchaser will have the use of the plant, which includes both the land and the building. The lease agreement calls for monthly rent installments of 13,000 Euros (approximately $19,000 Canadian dollars) over the term of the lease to 2023. Consideration in connection with this transaction was allocated as follows:

| | Canadian dollar values |
|---|---|
| Note receivable | $ 1,938 |
| Lease receiveable | 3,908 |
| **Total consideration** | $ 5,846 |
| | |
| Inventory | $ 954 |
| Property, plant and equipment | 5,913 |
| Goodwill | 452 |
| Pension | (323) |
| Other employee liabilities | (128) |
| **Total assets sold** | $ 6,868 |
| **Loss on disposition** | $ 1,022 |

The lease receivable is calculated based on the present value of the future principal and interest cash flows, discounted at the market rate of interest at the lease inception date, determined to be 1.15%. Unless one of the Parties sends to the other a twelve month prior written notice of termination, at the end of each six year term, the Agreement will be automatically renewed by an equal period.

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As at December 31, 2017, consideration receivable consists of:

| | | December 31, 2017 |
|---|---|---|
| Lease receivable of 2,597 EUR, with monthly lease payments of 13 EUR, bearing interest of 1.15% per annum. Gross cash entitlement: | $ | 4,138 |
| Less: unearned finance income | | (230) |
| Net lease receivable: | | 3,908 |
| Note receivable of 1,238 EUR, repayment schedule of 263 EUR April 30, 2018; 363 EUR October 31, 2018; 662 EUR October 31, 2019, non-interest bearing, secured by the property, plant and equipment of the VPI business | | 1,864 |
| | $ | 5,772 |
| Less current portion | | 1,167 |
| | $ | 4,605 |

The aggregate amount of principal payments to be received in each of the next five years is as follows:

| | | |
|---|---|---|
| 2018 | | 1,167 |
| 2019 | | 1,437 |
| 2020 | | 149 |
| 2021 | | 149 |
| 2022 and thereafter | | 2,870 |
| | $ | 5,772 |

**Put and call option**

The lease agreement includes a put and call option related to the leased premises, exercisable within 60 days after September 30, 2023. The call option grants the purchaser an option to purchase the premises for consideration equal to 2,225,000 Euros. The put option grants HPS an option to sell the plant to the purchaser for consideration equal to the initial plant purchase price of 2,225,000 Euros. Under both the call and put option the plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375,000 Euros (approximately $563,000 Canadian dollars). If the purchaser fails to execute the put option, the purchaser will pay 500,000 Euros (approximately $750,000 Canadian dollars) in damages.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 8. Property, plant and equipment

| Cost | Land | Building | Leaseholds & Improvements | Machinery & Equipment | Office | Construction In Progress | Total |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2016 | $ 6,826 | $27,806 | $ 1,502 | $56,160 | $ 9,922 | $ 201 | $ 102,417 |
| Additions | – | 597 | 171 | 992 | 348 | 56 | 2,164 |
| Disposals | – | (11) | – | (390) | (43) | – | (444) |
| Effect of movements in exchange rates | (175) | (581) | (227) | (1,624) | (202) | (4) | (2,813) |
| Balance at December 31, 2016 | $ 6,651 | $27,811 | $ 1,446 | $55,138 | $10,025 | $ 253 | $ 101,324 |
| Balance at January 1, 2016 | $ 6,651 | $27,811 | $ 1,446 | $55,138 | $10,025 | $ 253 | $ 101,324 |
| Additions | – | 94 | 41 | 1,727 | 478 | (21) | 2,319 |
| Disposals | (1,939) | (5,391) | (87) | (2,357) | (45) | – | (9,819) |
| Effect of movements in exchange rates | 156 | (1,612) | (53) | 1,611 | (9) | – | 93 |
| Balance at December 31, 2017 | $ 4,868 | $20,902 | $ 1,347 | $56,119 | $10,449 | $ 232 | $ 93,917 |
| **Accumulated Depreciation** | | | | | | | |
| Balance at January 1, 2016 | $ – | $ 9,948 | $ 1,029 | $37,429 | $ 8,786 | $ – | $ 57,192 |
| Depreciation for the year | – | 1,078 | 109 | 3,840 | 411 | – | 5,438 |
| Disposals | – | – | – | (182) | (42) | – | (224) |
| Effect of movements in exchange rates | – | (297) | (14) | (1,133) | (148) | – | (1,592) |
| Balance at December 31, 2016 | $ – | $10,729 | $ 1,124 | $39,954 | $ 9,007 | $ – | $ 60,814 |
| Balance at January 1, 2017 | $ – | $10,729 | $ 1,124 | $39,954 | $ 9,007 | $ – | $ 60,814 |
| Depreciation for the year | – | 1,123 | 119 | 3,501 | 357 | – | 5,100 |
| Disposals | – | (1,785) | (97) | (1,910) | (40) | – | (3,832) |
| Effect of movements in exchange rates | – | (22) | (52) | (354) | (13) | – | (441) |
| Balance at December 31, 2017 | $ – | $ 10,045 | $ 1,094 | $41,191 | $ 9,311 | $ – | $ 61,641 |
| **Carrying amounts** | | | | | | | |
| At December 31, 2016 | $ 6,651 | $17,082 | $ 322 | $15,184 | $ 1,018 | $ 253 | $ 40,510 |
| At December 31, 2017 | $ 4,868 | $10,857 | $ 253 | $14,928 | $ 1,138 | $ 232 | $ 32,276 |

Depreciation is recorded in the statement of earnings as follows: cost of sales $4,747,000 (2016 – $5,109,000), selling and distribution $15,000 (2016 – $16,000) and general and administrative $338,000 (2016 – $313,000).

## 9. Investment in properties

The Group has a 50% ownership interest in a property in Georgetown, Ontario (referred to as the Glen Ewing Properties). It is a vacant plot of land currently under environmental remediation, and no revenue was derived from it in 2017 or 2016. The property is carried at cost. The estimated fair value of the property as at December 31, 2017 is $1,150,000 (2016 – $1,150,000). The fair value was determined based on independent available market evidence. The Group's share of ongoing legal, consulting and remediation costs during the year was $52,000 (2016 – $106,000).

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 10. Investment in joint venture

The Company has a 55% economic and voting interest in Corefficient. By virtue of the contractual arrangement with National Material L.P., the other shareholder in Corefficient, decisions about significant, relevant, operating and strategic activities require the unanimous consent of both parties, and therefore the Company jointly controls Corefficient. Distributions of dividends and returns of capital from Corefficient are subject to unanimous Corefficient shareholder approval. Accordingly, the Company has treated its investment in Corefficient as a joint arrangement. Corefficient's principal place of business is in Monterrey, Mexico. The carrying value of the Company's interest in Corefficient is as follows:

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Cost of investment in joint venture | $ 19,304 | $ 18,678 |
| Cumulative share of loss in investment in joint venture, net of tax | (3,778) | (3,248) |
| Foreign currency translation differences related to the joint venture | (3,368) | (2,158) |
| | $ 12,158 | $ 13,272 |

During the year the Company made additional contributions of $626,000 (2016 – $4,580,000) and recognized its share of the loss of $530,000 (2016 – $2,400,000).

Selected financial information relating to Corefficient is as follows:

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Cash | $ 2,261 | $ 800 |
| Trade and other receivables | 5,546 | 5,486 |
| Inventories | 1,050 | 575 |
| Other current assets | 162 | 985 |
| Total current assets | $ 9,019 | $ 7,846 |
| Non-current assets | 16,487 | 18,484 |
| **Total assets** | $ 25,506 | $ 26,330 |
| Current liabilities | $ 3,671 | $ 2,357 |
| Non-current liabilities | – | – |
| **Total liabilities** | $ 3,671 | $ 2,357 |

| | **2017** | **2016** |
|---|---|---|
| Revenue | $ 18,982 | $ 14,982 |
| Loss for the year | 1,619 | 3,394 |

The loss for the year ended December 31, 2017 includes depreciation and amortization expense of $1,876,000 (2016 – $1,836,000), interest income of $204,000 (2016 – expense of $6,000) and an income tax recovery of $825,000 (2016 – $1,359,000) related to Corefficient.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 11. Intangible assets and goodwill

| Intangible assets | Technology | Customer lists relationships and branding | Externally acquired software | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at January 1, 2016 | $ 6,752 | $ 9,089 | $ 5,588 | $ 21,429 |
| Additions | – | – | 281 | 281 |
| Effect of movements in exchange rates | (364) | (214) | (67) | (645) |
| Balance at December 31, 2016 | $ 6,388 | $ 8,875 | $ 5,802 | $ 21,065 |
| Balance at January 1, 2017 | $ 6,388 | $ 8,875 | $ 5,802 | $ 21,065 |
| Additions | – | – | 128 | 128 |
| Effect of movements in exchange rates | 189 | 78 | (4) | 263 |
| Balance at December 31, 2017 | $ 6,577 | $ 8,953 | $ 5,926 | $ 21,456 |
| **Accumulated Amortization** | | | | |
| Balance at January 1, 2016 | $ 1,286 | $ 3,965 | $ 2,320 | $ 7,571 |
| Amortization for the year | 325 | 659 | 411 | 1,395 |
| Effect of movements in exchange rates | (77) | (74) | (31) | (182) |
| Balance at December 31, 2016 | $ 1,534 | $ 4,550 | $ 2,700 | $ 8,784 |
| Balance at January 1, 2017 | $ 1,534 | $ 4,550 | $ 2,700 | $ 8,784 |
| Amortization for the year | 326 | 648 | 451 | 1,425 |
| Effect of movements in exchange rates | 46 | 48 | (13) | 81 |
| Balance at December 31, 2017 | $ 1,906 | $ 5,246 | $ 3,138 | $ 10,290 |
| **Carrying amounts** | | | | |
| At December 31, 2016 | $ 4,854 | $ 4,325 | $ 3,102 | $ 12,281 |
| At December 31, 2017 | $ 4,671 | $ 3,707 | $ 2,788 | $ 11,166 |

Amortization of $330,000 (2016 – $304,000) has been recognized in cost of sales, $185,000 (2016 – $192,000) has been recognized in selling and distribution and $910,000 (2016 – $899,000) has been recognized in general and administrative.

None of the intangible assets has been internally developed.

Research and development expenses of $1,303,000 (2016 – $1,219,000) have been recognized in cost of sales in the consolidated statements of earnings. No research and development costs have been capitalized (2016 – $nil).

| Goodwill | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Opening balance | $ 17,220 | $ 19,606 |
| Impairment (note 12) | – | (1,417) |
| Disposal (note 7) | (452) | – |
| Effect of movements of exchange rates | 254 | (969) |
| Ending balance | $ 17,022 | $ 17,220 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 12. Impairment testing for cash-generating units

The Company has defined its cash generating units primarily as each manufacturing and contract manufacturing location, due to the fact that each location is managed separately and has its own dedicated human resources and property, plant and equipment. Each manufacturing facility produces products largely independent of the other facilities and is ultimately responsible for producing products that generate revenue.

The Company monitors the performance of each manufacturing unit through the use of profitability analysis, and also considers the profitability of each manufacturing unit relative to the Company's business plan.

The Company conducts its annual impairment assessment of goodwill, intangible assets and property, plant and equipment in the fourth quarter of each year, which corresponds with its annual planning cycle, and whenever events or changes in circumstances indicate that the carrying amount of an asset or CGU may not be recoverable. The Company recognizes an impairment loss when the carrying amount of an asset or CGU exceeds its recoverable amount, which is measured at the greater of its value in use and fair value less costs of disposal.

Where there were indicators of impairment, or where goodwill was allocated to a cash generating unit, the Company performed an impairment test using the value in use method. Prior to the Company's 2017 annual impairment assessment, the Company did not identify any triggering events during the course of 2017 indicating that the carrying amount of its assets and CGU's may not be recoverable.

**Impairment testing for cash-generating units containing goodwill**

For its 2017 annual impairment assessment of CGU's containing goodwill the Company used cash flow projections based primarily on its plan for the following year, and projections for the ensuing four year period. The Company's plan for the following year is primarily based on financial projections submitted by its subsidiaries in the fourth quarter of each year, together with inputs from customer teams. This plan is subjected to reviews by various levels of management as part of its annual planning cycle, and is approved by the Board of Directors. The values used in the cash flow projections are based on historical sales, internal growth rate assumptions, and available market data. Assumptions used in cash flow projections are based on improving economic conditions as evidenced by recent GDP growth statistics.

Based on these projections, a five year present value cash flow projection was completed and discounted using discount rates specific to each CGU ranging from 11.3% – 18.7% (2016 12.5% – 18.8%) depending on the location of the entity. Through the five year cash flow projections, the Company's model also incorporated annual sales growth (decline) rates in the range of (11%) – 23% (2016 (2%) – 38%) depending on location, the CGU's operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using steady growth rates ranging from 2% – 10% (2016 2% – 8%), depending on the geography of the manufacturing unit. This was then compared to the carrying value of the CGU to determine if there was impairment.

The Company has three subsidiaries identified as cash generating units that contain goodwill. The cash generating units ("CGU's") and their respective goodwill balances are as follows: Delta Transformers Inc. $2,180,000 (2016 – $2,180,000), Hammond Power Solutions Private Limited $9,852,000 (2016 – $9,917,000) and HPS S.p.A. $4,990,000 (2016 – $5,123,000).

Upon completion of the 2017 annual impairment assessment of goodwill it was determined that the recoverable amount of the CGU's exceeded their respective carrying values and no impairment existed at December 31, 2017.

In conducting its annual impairment test for the year ended December 31, 2016, management determined the recoverable amount, using the value in use method, of HPS S.p.A. to be $24,445,000, which was less than the CGU's carrying amount by $1,417,000, primarily due to reduced customer demand and challenging European market conditions. Accordingly, for the year ended December 31, 2016, a goodwill impairment charge of $1,417,000 was recorded on the "Impairment of goodwill" line in the consolidated statements of earnings. Key assumptions utilized in the determination of the recoverable amount, and to which the recoverable amount is most sensitive, included projected growth in revenue in 2017 of 29%, followed by growth rates ranging from 13% – 15% through the remainder of the five year projection period and a steady growth rate of 5.0% thereafter, anticipated gross margin rates ranging from 18% – 21% throughout the projection period, and selling, general and administrative costs ranging from 10% – 15% as a percentage of revenue throughout the projection period. Projected cash flows were discounted using a discount rate of 18.8%.

Management's approach to determining anticipated sales levels includes consideration of current bookings, consultation with its salesforce, and historical results. The Company's process for determining anticipated gross margin rates includes consideration of current pricing information from suppliers and historical gross margin rates realized by the Company. Anticipated gross margin rates are reflective of those that have been achieved in the past. Selling, general and administrative costs are determined with reference to past results and incorporate planned initiatives the Company may take to manage costs and achieve planned results.

Management believes that any reasonable possible change in the key assumptions on which the recoverable amounts are based would not cause any of the CGU's carrying amounts to materially exceed their recoverable amounts.

Impairment assessments inherently involve judgment as to assumptions about expected future cash flows and the impact of market conditions on those assumptions. Future events and changing market conditions may impact the Company's assumptions as to prices, costs or other factors that may result in changes in the Company's estimates of future cash flows. Failure to realize the assumed revenues at an appropriate profit margin or failure to improve the financial results of a CGU could result in impairment losses in the CGU in future periods.

## 13. Bank operating lines of credit

The Group's North American current banking agreement, which expires in June, 2021, consists of a $40,000,000 U.S. revolving credit facility and a $10,000,000 U.S. delayed draw credit facility. The delayed draw facility does not charge any fees on the unutilized balance. The use of the delayed draw facility needs to be approved by the bank. The draw is available in a minimum of two tranches of $5,000,000 U.S. each. The facilities are unsecured.

The delayed draw credit facility was unutilized at December 31, 2017 and December 31, 2016. Under the terms of the facility, the Group pays a commitment fee at rates ranging from 0.30% to 0.40% payable quarterly in arrears, on the daily amount of the unused portion of the revolving North American commitment.

Interest on the revolving credit lines is dependent on certain financial ratios and ranges from Canadian bank prime rate minus 0.50% to Canadian bank prime rate for the Canadian dollar denominated revolving credit lines or, if designated, the bank's CDOR rate plus 1.25% to 1.75% and from U.S. base rate minus 1.50% to U.S. base rate minus 1.00% for the U.S. dollar denominated revolving credit lines or, if designated, the bank's LIBOR rate plus 1.25% to 1.75%.

The Group also has a 4,070,000 unsecured Euro facility, that matures May 2018 and may be renewed in writing each year to extend the maturity date for the facility for a further 365 days, subject to approval from the lender. The facility is made up of a 3,750,000 Euro revolver and 250,000 Euro overdraft facility, as well as a 70,000 Euro letter of credit line. The revolver facility bears interest at Euribor plus margin of 1.75% (Euribor on Dec 31, 2017 – 0.368%).

Hammond Power Solutions Private Limited maintains an additional demand credit facility for an unsecured working capital loan up to $375,000,000 INR. (2016 – $270,000,000 INR.) consisting of the sub-facilities of an 178,000,000 INR (2016 – 105,000,000 INR) short-term working capital demand loan, a 189,000,000 INR (2016 – 120,000,000 INR) facility for bank guarantees and letters of credit and 8,000,000 INR (2016 – 45,000,000 INR) facility for bill discounting export facility. The demand loan bears interest at a MCLR + 2.5% and the bank guarantees are at a rate of 1.0%. As at December 31, 2017, there was $2,825,000 Canadian dollar equivalent of Rupees drawn against the working capital demand loan (2016 – $2,488,000). At December 31, 2017 there was 146,000,000 INR drawings against the bank guarantees. There was no drawings against the bill discounting facility.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

Based on exchange rates in effect at December 31, 2017, the combined Canadian dollar equivalent available prior to any utilization of the facilities was $76,216,000 (2016 – $78,240,000).

As at December 31, 2017, the Canadian dollar equivalent outstanding under the U.S. dollar revolving credit line was $20,226,000 (2016 – $29,131,000). As well, $4,704,000 (2016 – $4,888,000) Canadian dollar equivalent of Euros was outstanding under the Euro facility, and $2,825,000 (2016 – $2,488,000) Canadian dollar equivalent of Indian rupees under the Rupee facility. Amounts drawn on the facility have been recognized as current liabilities based on the Company's anticipated repayment plans.

## 14. Commitments and contingencies

**Commitments**

The Company has entered into various non-cancellable operating leases. The future minimum lease payments for years subsequent to the periods below are as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Less than 1 year | $ 2,094 | $ 2,126 |
| 2 to 5 years | $ 2,488 | $ 3,916 |

Operating lease payments recognized as an expense during the year were $1,891,000 (2016 – $1,736,000).

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Capital expenditure commitments | $ 20 | $ 148 |

**Contingent liability**

In December 2013, the Corporation received notice of an environmental claim from the owner of a property located nearby to a property that was once partially owned by the Corporation. At this time the Company feels that there is no merit to the claim.

## 15. Income taxes

**Income tax expense**

| | 2017 | 2016 |
|---|---|---|
| **Current tax expense** | | |
| Current period | $ 5,734 | $ 5,392 |
| **Deferred tax expense (recovery)** | | |
| Origination and reversal of temporary differences | (257) | (723) |
| Increase in tax rate | 254 | (6) |
| | (3) | (729) |
| Total income tax expense | $ 5,731 | $ 4,663 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**Reconciliation of effective tax rate**

| | 2017 | | 2017 | 2016 | | 2016 |
|---|---|---|---|---|---|---|
| Net earnings | | $ | 6,114 | | $ | 1,793 |
| Income tax expense | | | 5,731 | | | 4,663 |
| Earnings before income taxes | | $ | 11,845 | | $ | 6,456 |
| Income tax using the Company's domestic tax rate | 39.50% | | 4,679 | 39.50% | | 2,550 |
| Effect of tax rates in foreign jurisdictions | 2.15% | | 255 | (1.01%) | | (65) |
| Increase in tax rate | 2.49% | | 295 | (0.09%) | | (6) |
| Non-deductible expenses/non-taxable income | 0.66% | | 78 | 19.02% | | 1,228 |
| Increased (reduced) rate for active business and manufacturing and processing | (3.26%) | | (386) | 10.38% | | 670 |
| Losses for which no deferred tax asset was recognized | 4.32% | | 512 | 6.44% | | 416 |
| Other | 2.52% | | 298 | (2.01%) | | (130) |
| | 48.38% | $ | 5,731 | 72.23% | $ | 4,663 |

**Unrecognized temporary differences**

At December 31, 2017, pre-tax temporary differences of $72,063,000 (2016 – $77,455,000) related to investments in subsidiaries were not recognized because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Deferred tax assets have not been recognized in respect of the following items:

| | 2017 | | 2016 |
|---|---|---|---|
| Tax losses | $ 6,190 | $ | 3,705 |
| Financial interests deductible in a future period | 1,017 | | 957 |
| | $7,207 | $ | 4,662 |

The tax losses carry forward indefinitely and relate to HPS S.p.A. The benefit of these losses has not been reflected in the consolidated financial statements as it is uncertain as to whether the Company will be able to utilize these losses.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**Recognized deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

| | Assets | | Liabilities | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| Property, plant and equipment | $ 731 | $ 205 | $ (3,173) | $ (4,847) |
| Intangible assets | 13 | 14 | (1,930) | (2,379) |
| Scientific research and experimental development | 57 | 43 | (103) | (62) |
| Inventories | 311 | 243 | – | (8) |
| Long-term lease and note receivable | – | – | (1,090) | – |
| Loans and borrowings | – | 546 | – | – |
| Employee benefits | 71 | – | (129) | (126) |
| Unrealized losses (gains) on forward contracts and foreign-currency denominated loans payable/receivable | 410 | 1,217 | (198) | (107) |
| Provisions and tax reserves | 1,514 | 1,297 | – | (20) |
| Tax loss carry-forwards | 950 | 1,487 | – | – |
| Charitable donation carry-forwards | – | 14 | – | – |
| Tax assets (liabilities) | 4,057 | 5,066 | (6,623) | (7,549) |
| Set off of tax | (3,281) | (3,518) | 3,281 | 3,518 |
| Net tax assets (liabilities) | $ 776 | $ 1,548 | $ (3,342) | $ (4,031) |

Movement in temporary differences during the year

| | Balance December 31, 2016 | Recognized in profit or loss | Recognized in other comprehensive income | Balance December 31, 2017 |
|---|---|---|---|---|
| Property, plant and equipment | $ 4,642 | $ (2,200) | $ – | $ 2,442 |
| Intangible assets | 2,365 | (448) | – | 1,917 |
| Scientific research and experimental development | 19 | 27 | – | 46 |
| Inventories | (235) | (76) | – | (311) |
| Long-term lease and note receivable | – | 1,090 | – | 1,090 |
| Loans and borrowings | (546) | 546 | – | – |
| Employee benefits | 126 | (68) | – | 58 |
| Unrealized gains on forward contracts and foreign-denominated loans payable/receivable | (1,110) | 898 | – | (212) |
| Provisions and tax reserves | (1,277) | (237) | – | (1,514) |
| Tax loss carry-forwards | (1,487) | 537 | – | (950) |
| Charitable donation carry-forwards | (14) | 14 | – | – |
| | $ 2,483 | $ 83 | $ – | $ 2,566 |
| Foreign exchange | | $ (86) | | |
| Income tax expense | | $ (3) | | |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

Movement in temporary differences during the year

| | Balance December 31, 2015 | Recognized in profit or loss | Recognized in other | Balance December 31, 2016 |
|---|---|---|---|---|
| Property, plant and equipment | $ 6,316 | $ (1,674) | $ – | $ 4,642 |
| Intangible assets | 2,725 | (360) | – | 2,365 |
| Scientific research and experimental development | 33 | (14) | – | 19 |
| Inventories | (231) | (4) | – | (235) |
| Loans and borrowings | (1,830) | 1,284 | – | (546) |
| Employee benefits | (27) | 153 | 5 | 126 |
| Unrealized gains (losses) on forward contracts and foreign-denominated loans payable/receivable | (940) | (170) | – | (1,110) |
| Provisions | (1,267) | (10) | – | (1,277) |
| Tax loss carry-forwards | (1,547) | 60 | – | (1,487) |
| Charitable donation carry-forwards | (2) | (12) | – | (14) |
| | $ 3,230 | $ (747) | $ 5 | $ 2,483 |
| Foreign exchange | | $ 18 | | |
| Income tax expense | | $ (729) | | |

## 16. Share capital

**(a) Authorized:**

Unlimited number of special shares, discretionary dividends, non-voting, redeemable and retractable.

Unlimited number of Class A subordinate voting shares, no par value.

Unlimited number of Class B common shares with four votes per share, convertible into Class A subordinate voting shares on a one-for-one basis. Annual dividends on the Class B common shares may not exceed the annual dividends on the Class A subordinate voting shares, no par value.

**(b) Issued:**

| | | December 31, 2017 | December 31, 2016 |
|---|---|---|---|
| 8,941,624 | Class A subordinate voting shares (2016 – 8,921,624) | $ 13,979 | $ 13,836 |
| 2,778,300 | Class B common shares (2016 – 2,778,300) | 7 | 7 |
| 11,719,924 | Total A and B shares (2016 – 11,699,924) | $ 13,986 | $ 13,843 |

During the year ended December 31, 2017, 20,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $124,000 and a transfer of $19,000 from contributed surplus. The weighted average share price on the dates the options were exercised was $9.08. There were no stock options exercised during the year ended December 31, 2016.

The following dividends were declared and paid by the Company:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| 24 cents per Class A subordinate voting shares (2016 – 24 cents) | $ 2,142 | $ 2,141 |
| 24 cents per Class B common shares (2016 – 24 cents) | 667 | 667 |
| | $ 2,809 | $ 2,808 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**(c) Stock option plan**

The Company uses a stock option plan to attract and retain key employees, officers and directors. The shareholders have approved a maximum of 1,200,000 Class A shares for issuance under the Stock Option Plan, with the maximum reserved for issuance to any one person at 5% of the Class A shares outstanding calculated immediately prior to the time of the grant. As per the Stock Option Plan, the Board of Directors may, at its sole discretion, determine the time during which the Options shall vest and the method of vesting, or that no vesting restriction shall exist. The stock option exercise price is the price of the Company's common shares on the Toronto Stock Exchange at closing for the day prior to the grant date on which the Class A shares traded. The period during which an option will be outstanding shall be 7 years, or such other time fixed by the Board of Directors, subject to earlier termination upon the option holder ceasing to be a director, officer or employee of the Company. Options issued under the plan are non-transferable unless specifically provided in the Stock Option Plan. Any option granted, which is cancelled or terminated for any reason prior to exercise, shall become available for future stock option grants. All options are to be settled by physical delivery of shares.

There were no options granted for the year ended December 31, 2017. During the prior year, the Company granted 160,000 options, of which 115,000 vested immediately, 22,500 vested during 2017 and the remaining 15,000 will vest during the first quarter of 2018. During 2016, 20,000 options which were granted in 2015 vested. Stock-based compensation recognized and the amount credited to contributed surplus during the year is $14,000 and relates to options granted in prior years that vested during the year. The stock-based compensation expense recognized and amount credited to contributed surplus in 2016 amounted to $171,000. The weighted average grant date fair value of options granted in 2016 was $0.96.

Options outstanding and exercisable as at December 31, 2017:

| | **December 31, 2017** | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Number of options | | Weighted average exercise price | Number of options | | Weighted average exercise price |
| Outstanding, beginning of year | 844,000 | $ | 8.98 | 709,000 | $ | 9.50 |
| Granted | – | | – | 160,000 | | 6.20 |
| Exercised | (20,000) | | 6.20 | – | | – |
| Cancelled | (40,000) | | 6.31 | – | | – |
| Expired | (90,000) | | 10.55 | (25,000) | | 5.91 |
| Outstanding, end of year | 694,000 | $ | 9.01 | 844,000 | $ | 8.98 |

| | | | Options outstanding | | | Options exercisable | | |
|---|---|---|---|---|---|---|---|---|
| | Exercise price | Number of options outstanding | Weighted average remaining contractual life (years) | | Weighted average exercise price | Number of options exercisable | | Weighted average exercise price |
| $ | 11.70 | 155,000 | 0.2 | $ | 11.70 | 155,000 | $ | 11.70 |
| | 9.74 | 119,000 | 1.2 | | 9.74 | 119,000 | | 9.74 |
| | 10.00 | 140,000 | 2.2 | | 10.00 | 140,000 | | 10.00 |
| | 7.50 | 85,000 | 3.2 | | 7.50 | 85,000 | | 7.50 |
| | 6.62 | 85,000 | 4.2 | | 6.62 | 85,000 | | 6.62 |
| | 6.20 | 110,000 | 5.2 | | 6.20 | 95,000 | | 6.20 |
| | | 694,000 | 2.4 | $ | 9.01 | 679,000 | $ | 9.07 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

In the year ended December 31, 2017, 40,000 options were cancelled related to the termination of an Officer of the Company.

**Terms and conditions of the stock option plan**

Options grants detailed below vest as follows:

- Options granted to directors vest immediately.
- Options granted to officers and senior management vest evenly over two or three years from the grant date, with one-half of the grant vesting immediately for grants with a two-year vesting period, and one-third of the grant vesting immediately for grants with a three-year vesting period.

The contractual life of the options granted below is seven years from the grant date.

| Option Grant Date | Number of Options | Recipients |
|---|---|---|
| March 17, 2011 | 155,000 | Board of Directors, Officers and Senior Management |
| March 16, 2012 | 119,000 | Board of Directors, Officers and Senior Management |
| March 14, 2013 | 140,000 | Board of Directors, Officers and Senior Management |
| March 13, 2014 | 85,000 | Board of Directors, Officers and Senior Management |
| March 12, 2015 | 85,000 | Board of Directors and Officers |
| March 10, 2016 | 110,000 | Board of Directors and Officers |
| Total stock options outstanding | 694,000 | |

**Inputs for measurement of grant date fair values**

The grant date fair value of share-based payment plans was measured based on the Black-Scholes formula. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at grant date of the share-based payment plans are the following:

| | **2017** | 2016 |
|---|---|---|
| **Fair value of share options and assumptions** | | |
| Fair value at grant date | $ – | $ 0.96 |
| Share price at grant date | $ – | $ 6.20 |
| Exercise price | $ – | $ 6.20 |
| Expected volatility (weighted average volatility) | – | 39.4% |
| Option life (expected weighted average life) | – | 3.8 years |
| Expected dividends | – | 3.90% |
| Risk-free interest rate (based on government bonds) | – | 1.44% |
| Forfeiture rate | – | 1.29% |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**(c) Deferred Share Units**

During 2017, the Company enacted deferred share unit plan (the "DSU Plan") in order to issue deferred share units ("DSU's") to non-employee directors and senior-executives (collectively, "participants") of HPS. The DSU Plan was adopted to allow participants the opportunity to defer compensation and encourage a sense of ownership in HPS. Under the DSU Plan, participants may elect to defer compensation and receive DSU's equal to the value of the deferred compensation. The first DSU's were issued in March 2017. The number of DSU's was determined by dividing the amount of deferred compensation by the Fair Market Value of DSU's, defined in the DSU Plan as the weighted average closing price of HPS shares for the five business days immediately preceding the relevant date. Upon the occurrence of the Redemption Event, which could include ceasing to hold any position in the Company and/or any Subsidiary or upon death of the participant, the affected participant will be entitled to receive a lump sum cash payment, net of applicable withholding taxes, equal to the product of number of DSU's held by that participant and the Fair Market Value on the date of the Redemption Event. The DSU's do not contain any vesting conditions or forfeiture provisions, as they are issued in exchange for deferred compensation. Under the DSU Plan, outstanding DSU's as at the record date are increased by the dividend rate whenever dividends are paid to shareholders.

The DSU's issued are not performance based.

The movement in DSU's for the year ended December 31, 2017 is as follows:

| | **Number of DSU's** | Closing Share Price |
|---|---|---|
| Balance at January 1, 2017 | – | $ – |
| DSU's Issued | 32,578 | 9.16 |
| **Balance at December 31, 2017** | 32,578 | $ 9.16 |

An expense of $285,000 was recorded in general and administrative expenses. The liability for these DSU's is included in accounts payable and accrued liabilities.

## 17. EARNINGS PER SHARE

The computations for basic and diluted earnings per share are as follows:
(earnings in thousands of dollars)

| | **2017** | 2016 |
|---|---|---|
| Basic earnings per share | $ 0.53 | $ 0.16 |
| Calculated as: | | |
| Net Earnings attributable to the equity holders of the Company | $ 6,154 | $ 1,823 |
| Weighted average number of shares outstanding | 11,707,424 | 11,699,424 |
| | | |
| Fully diluted earnings per share | $ 0.52 | $ 0.16 |
| Calculated as: | | |
| Net Earnings attributable to the equity holders of the Company | $ 6,154 | $ 1,823 |
| Weighted average number of shares outstanding including effects of dilutive potential ordinary shares | 11,732,982 | 11,705,622 |
| | | |
| Reconciliation of weighted average number of shares outstanding: | | |
| Weighted average number of shares outstanding used to calculate basic earnings per share | 11,707,424 | 11,699,924 |
| Adjustment for dilutive effect of stock option plan | 25,558 | 5,698 |
| Weighted average number of shares outstanding used to calculate diluted earnings per share | 11,732,982 | 11,705,622 |

As at December 31, 2017, 499,000 options (2016 – 844,000) are excluded from the diluted average number of shares calculation as their effect would have been anti-dilutive.

## 18. Non-controlling interest

**Put and call option**

In relation to the non-controlling interest in Hammond Power Solutions Private Limited, HPS has an irrevocable call option exercisable at any time after February 23, 2016, and in certain other circumstances, to purchase the remaining securities of Hammond Power Solutions Private Limited from the non-controlling interest at fair value and has also granted a put option exercisable at any time after February 23, 2019, and in certain other circumstances, to cause HPS to purchase the remaining securities of Hammond Power Solutions Private Limited at fair value from the non-controlling interest. As the exercise price of the call and put option are at fair value, the fair value of the instruments are considered nominal. The Company has not recognized the present value of the redemption cost of the put option as a liability as at December 31, 2017 as it is not considered material to the consolidated financial statements. Subsequent to year-end, the Company exercised its call option and purchased the remaining minority interest of Hammond Power Solutions Private Limited (see note 29).

**Purchase of non-controlling Interest**

In 2016, HPS purchased the shares of K. Linga Reddy, a minority shareholder of Hammond Power Solutions Private Limited in India, acquiring an additional 15% equity ownership for 172,625,181 Indian Rupees ($3,326,000 CAD) and increasing HPS's equity ownership of Hammond Power Solutions Private Limited to 85%. The impact of this transaction was a reduction in minority interest in the amount of $2,291,000 a decrease in accumulated other comprehensive income in the amount of $125,000 and a reduction in retained earnings in the amount of $910,000.

## 19. Pension plans

**(a) Defined contribution plan:**

The Group has defined contribution pension plans that are available to virtually all of its employees with eligible employee contributions based on 2.00% – 6.75% of annual earnings. The Group's contributions of $1,348,000 (2016 – $1,323,000) matches the employee contributions. The Group's contributions related to its defined contribution pension plans are recorded as follows: $1,007,000 (2016 – $985,000) in cost of sales, $168,000 (2016 – $167,000) in selling and distribution, and $173,000 (2016 – $171,000) in general and administrative.

**(b) Defined benefit plans:**

In connection with its Italian operations, the Group is subject to an Italian statutory liability to make termination payments to employees upon their cessation of employment with the Group, either voluntary or involuntary. Italian employment law prescribes the formula under which an annual amount in respect of each employee is determined. This obligation is unfunded. The liability for past service relating to these employees does not change based on future wage escalation; however does increase based on an inflationary component. The Group accounts for the related projected benefit obligation at its present value. As at December 31, 2017 the obligation, recorded within accounts payable and accrued liabilities, was $700,000 (2016 – $1,268,000). During the year, the expense recognized related to this obligation was $158,000 (2016 – $178,000), of which $69,000 (2016 – $77,000) is included within cost of sales, $31,000 (2016 – $38,000) in selling and distribution, and $58,000 (2016 – $63,000) in general and administrative. In connection with the disposal of the VPI product line, the purchaser assumed an obligation in respect of this liability in the amount of $323,000.

In addition, the Group maintained a contributory, defined benefit pension plan covering all of its former hourly employees in Baraboo, Wisconsin. During 2016 this plan was curtailed and the liability was settled in full. The final payment amount was approximately $301,000, the liability extinguished was $389,000 and the difference, in the amount of $88,000, was recognized in income.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 20. Provisions

| | | Warranties | | Site restoration | | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2016 | $ | 428 | $ | 178 | $ | 606 |
| Provisions made during the period | | 469 | | 130 | | 599 |
| Provisions used during the period | | (435) | | (130) | | (565) |
| Balance at December 31, 2016 | $ | 462 | $ | 178 | $ | 640 |
| Balance at January 1, 2017 | $ | 462 | $ | 178 | $ | 640 |
| Provisions made during the period | | 480 | | 130 | | 610 |
| Provisions used during the period | | (563) | | (130) | | (693) |
| Balance at December 31, 2017 | $ | 379 | $ | 178 | $ | 557 |
| Current portion | $ | 379 | $ | 78 | $ | 457 |
| Non-current portion | $ | – | $ | 100 | $ | 100 |

**Warranties**

The provision for warranties relates mainly to transformers sold during the years ended December 31, 2017 and December 31, 2016. The provision is based on estimates made from historical warranty data associated with similar products and claims experience. The Group expects to incur most of the liability over the next year.

**Site restoration**

The Group has committed to undertaking a joint remediation plan for the Glen Ewing property with the owner of an adjoining industrial property and the co-owner of the property. The Group has recorded a liability for its estimated portion of the joint remediation.

## 21. Restructuring charges

The Company incurred restructuring charges of $1,386,000 for the year ended December 31, 2017. These charges were comprised of severance and benefit costs relating to workforce reductions. The restructuring activities were undertaken to adjust the Company's cost structure, to streamline various support activities in consideration of the current and expected industry market conditions. These charges are reported in the restructuring charge linwithin the consolidated statement of earnings.

The following table highlights the activity and balance of the restructuring charge for the twelve month period ending December 31, 2017:

| | | Employee Termination Benefits |
|---|---|---|
| Charges to expense | $ | 1,386 |
| Cash payments | | (1,057) |
| **Accrued balance at December 31, 2017** | $ | 329 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 22. Related party transactions

**Related parties**

Arathorn Investments Inc. beneficially owns 2,778,300 (2016 – 2,778,300) Class B common shares of the Company, representing 100% of the issued and outstanding Class B common shares of the Company and 1,057,918 (2016 – 1,055,287) Class A subordinate voting shares of the Company, representing approximately 11.8% (2016 – 11.8%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. All of the issued and outstanding shares of Arathorn Investments Inc. are owned by William G. Hammond, Chief Executive Officer and Chairman of the Company. Total dividends paid during the year, directly and indirectly to William G. Hammond were $920,000 (2016 – $920,000).

In the ordinary course of business, the Company enters into transactions with affiliated entities. A number of key management personnel or their related parties hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. All related party transactions in the normal course of operations are recorded at the exchange amount of consideration established by and agreed to by the related parties. The Group entered into the following transactions with other related parties:

| | Note | **2017** | 2016 | Relationship |
|---|---|---|---|---|
| Purchase of goods and services | (i) | $ 71 | $ 805 | Companies in which key management personnel and/or their relatives have significant influence. |

| | | **2017** | 2016 | Relationship |
|---|---|---|---|---|
| Amounts owed by related parties | | $ 2 | $ 1,962 | Companies in which key management personnel and/or their relatives have significant influence and key management personnel. |

**Transactions with key management personnel**

During the year, the Group purchased $229,000 (2016 – $245,000) of inventory from ILSCO of Canada Limited (“ILSCO”), a company in which HPS director David J. FitzGibbon serves as Vice Chairman. The Company purchases a component part from ILSCO which is utilized in the manufacturing of transformers. The purchases were measured at the exchange amount. Accounts payable and accrued liabilities include $30,000 (2016 – $30,000) which is owed to this company

(i) During the year ended December 31, 2017, HPS has paid nil (2016 – $10,000) in connection with rental agreements for office space and an apartment with K. Ravi Reddy, the minority shareholder of Hammond Power Solutions Private Limited in India. The balance relates to the purchase of raw materials, components and finished goods. The 2016 rent payment was made to minority shareholder K. Ravi Reddy.

**Key management personnel compensation**

Key management personnel include the Company’s directors and members of the executive management team. Compensation awarded to key management is as follows:

| | **2017** | 2016 |
|---|---|---|
| Salaries and benefits | $ 2,213 | $ 2,487 |
| Share-based awards | 299 | 171 |
| | $ 2,512 | $ 2,658 |

During the year, the Group made contributions of $51,000 (2016 – $102,000) to the defined contribution pension plan relating to employment service of key management personnel. An equivalent amount was contributed by key management personnel.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 23. Personnel expenses

| | | 2017 | | 2016 |
|---|---|---|---|---|
| Wages and salaries | $ | 51,757 | $ | 48,368 |
| Group portion of government pension and employment pension and employment benefits | | 14,623 | | 13,430 |
| Contributions to defined contribution plans | | 1,348 | | 1,323 |
| | $ | 67,728 | $ | 63,121 |

## 24. Change in operating working capital

The table below depicts the receipt of (use of) cash for working capital purposes by the Company:

| | | 2017 | | 2016 |
|---|---|---|---|---|
| Accounts receivable | $ | (9,201) | $ | 11,982 |
| Inventories | | 1,869 | | 2,386 |
| Prepaid expenses and other assets | | (465) | | (5) |
| Accounts payable and accrued liabilities | | 3,016 | | (5,376) |
| Foreign exchange | | (8,934) | | (4,186) |
| | $ | (13,715) | $ | 4,801 |

## 25. Segment disclosures

The Company operates in a single operating segment, being a manufacturer of transformers. The Company and its subsidiaries operate in Canada, the United States, Mexico, Italy and India. Inter-segment sales are made at fair market value.

| Geographic Segments | | 2017 | | 2016 |
|---|---|---|---|---|
| **Sales** | | | | |
| Canada | $ | 84,325 | $ | 77,711 |
| United States and Mexico | | 174,479 | | 159,982 |
| Italy | | 17,224 | | 18,442 |
| India | | 25,722 | | 18,658 |
| | $ | 301,750 | $ | 274,793 |
| **Property, plant and equipment – net** | | | | |
| Canada | $ | 19,628 | $ | 20,942 |
| United States and Mexico | | 3,689 | | 4,839 |
| Italy | | 6,370 | | 12,319 |
| India | | 2,589 | | 2,410 |
| | $ | 32,276 | $ | 40,510 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

| | | | | |
|---|---|---|---|---|
| **Investment in properties** | | | | |
| Canada | $ | 1,044 | $ | 1,044 |
| **Investment in joint venture** | | | | |
| Mexico | $ | 12,158 | $ | 13,272 |
| **Intangibles, net** | | | | |
| Canada | $ | 4,390 | $ | 4,995 |
| Italy | | 3,339 | | 3,532 |
| India | | 3,437 | | 3,754 |
| | $ | 11,166 | $ | 12,281 |
| **Goodwill** | | | | |
| Canada | $ | 2,180 | $ | 2,180 |
| Italy | | 4,990 | | 5,123 |
| India | | 9,852 | | 9,917 |
| | $ | 17,022 | $ | 17,220 |

## 26. Financial instruments

### Fair value

The fair value of the Group's financial instruments measured at fair value has been segregated into three levels. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Fair value of assets and liabilities included in Level 2 include valuations using inputs other than quoted prices for which all significant inputs are observable, either directly or indirectly. Fair value of assets and liabilities included in Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Group's financial instruments measured at fair value consist of foreign exchange forward contracts with a fair value of a liability of $292,000 (2016 – net asset of $39,000) and are included in Level 2 in the fair value hierarchy. To determine the fair value of the contracts, Management used a valuation technique in which all significant inputs were based on observable market data. There have been no transfers from or to Level 2 in 2017 or 2016.

The carrying values of cash and cash equivalents, accounts receivable, bank operating lines of credit, and accounts payable and accrued liabilities and other liabilities approximate their fair value due to the relatively short period to maturity of the instruments. The investment property is valued based on market evidence. The Group's note and lease receivable is valued at the present value of the future receipts.

### Derivative instruments

The Group has entered into forward foreign exchange contracts in order to reduce the Company's exposure to changes in the exchange rate of the U.S. dollar, Euro, Mexican Peso and Rupee as compared to the Canadian dollar. At December 31, 2017, the Company had outstanding forward foreign exchange contracts to buy U.S. $41,000,000 in CAD, sell EUR 7,650,000 in U.S., buy 850,000 EUR in CAD, sell EU 6,700,000 in CAD and sell U.S. $10,000,000 for Mexican Pesos at rates of 1.2578, 1.1999, 1.50827, 1.5066 and 19.792 respectively, all with maturity dates in January 2017. At December 31, 2016, the Company had outstanding forward foreign exchange contracts to buy U.S. $36,000,000 in CAD, sell EUR 7,350,000 in U.S., sell EUR 5,600,000 in CAD and sell U.S. $7,900,000 for Mexican Pesos at rates of 1.41920, 1.05860, 1.34210 and 20.69450 respectively, all with maturity dates in January 2017. As at December 31, 2017 the Group has recognized a net unrealized loss of $292,000 (2016 – gain of $39,000) representing the fair value of these forward foreign exchange contracts, with a corresponding obligation recognized in accrued liabilities (2016 – asset recognized in prepaid expenses and other assets).

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**Financial risk management**

The Group is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk, interest rate risk and commodity price risk) and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance.

Risk management is carried out by the finance department under the guidance of the Board of Directors. This department identifies and evaluates financial risks in close cooperation with management. The finance department is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated.

**Currency risk**

The Group operates internationally and is exposed to foreign exchange risk from various currencies, primarily U.S. dollars, Mexican Pesos, the Euro and the Indian Rupee. Foreign exchange risk arises mainly from U.S. dollar denominated purchases in Canada and Canadian sales to the U.S. as well as recognized financial assets and liabilities denominated in foreign currencies. The Company manages its foreign exchange risk by having geographically diverse manufacturing facilities and purchasing U.S. dollar raw materials in Canada. The Company also monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by entering into forward foreign exchange contracts. Forward foreign exchange contracts are only entered into for the purposes of managing foreign exchange risk and not for speculative purposes.

The following table represents the Group's balance sheet exposure to currency risk as at December 31:

| | U.S. Dollars | | Mexican Pesos | | Euros | | Indian Rupees | |
|---|---|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| Cash | $ 7,766 | $ 15,040 | 871 | 1,055 | € 291 | € 1,134 | 2,211 | 2,326 |
| Accounts receivable | 23,813 | 16,981 | 19,576 | 25,662 | 2,907 | 3,315 | 277,939 | 354,101 |
| Note receiveable | – | – | – | – | 1,238 | – | – | – |
| Long-term lease receiveable | – | – | – | – | 2,597 | – | – | – |
| Bank operating lines of credit | 3,346 | 3,743 | – | – | 3,218 | 3,488 | 143,852 | 125,839 |
| Accounts payable | 13,184 | 10,496 | 8,466 | 7,098 | 2,341 | 2,485 | 154,652 | 223,051 |
| Net exposure | $ 15,049 | $ 17,782 | 11,981 | 19,619 | € 1,474 | € (1,524) | (18,354) | 7,537 |

A one cent ($0.01) decline in the Canadian dollar against the U.S dollar as at December 31, 2017 would have decreased net earnings by $96,000 and increased equity by $199,000. This analysis assumes that all other variables, in particular interest rates, remained constant. Inversely, a 1 cent increase in the Canadian dollar against the U.S. dollar as at December 31, 2017 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Euro as at December 31, 2017 would have decreased net earnings by $47,000 and increased equity by $22,000. Inversely, a one cent increase ($0.01) in the Canadian dollar against the Euro as at December 31, 2017 would have had an equal but opposite effect.

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

A one cent ($0.01) decline in the Canadian dollar against the Indian Rupee as at December 31, 2017 would have decreased net earnings and equity by $4,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Indian Rupee as at December 31, 2017 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Peso as at December 31, 2017 would have decreased net earnings by $3,000 and increased equity by $9,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Peso as at December 31, 2017 would have had an equal but opposite effect.

**Credit risk**

Credit risk arises from the possibility that the Group's customers and counter parties may experience difficulty and be unable to fulfill their contractual obligations. The Group manages this risk by applying credit procedures whereby analyses are performed to control the granting of credit to its customer and counter parties based on their credit rating. As at December 31, 2017, the Group's accounts receivable are not subject to significant concentrations of credit risk. Both the long-term lease receivable and note receivable are subject to credit risk. The risk of the long-term lease is mitigated by the security of the related plant and the note receivable is secured by the VPI assets that were purchased. The Company's maximum exposure to credit risk associated with the Group's financial instruments is limited to their carrying amount.

During the year, the allowance for doubtful trade accounts receivables increased $834,000 (2016 –decreased $398,000), for which an expense was recognized in general and administrative expenses. The aging of accounts receivable and the related allowance is as follows:

| | **December 31, 2017** | | December 31, 2016 | |
|---|---|---|---|---|
| Not past due | $ 42,821 | $ – | $ 16,716 | $ – |
| Past due 0-30 days | 8,313 | – | 10,898 | – |
| Past due 31-120 days | 6,660 | – | 20,937 | – |
| Past due more than 120 days | 3,337 | 1,961 | 2,545 | 1,127 |
| | $ 61,131 | $ 1,961 | $ 51,096 | $ 1,127 |

**Credit risk**

The carrying amount of financial assets representing the maximum exposure to credit risk at the reporting date was:

| | Carrying Amount | |
|---|---|---|
| | **December 31, 2017** | December 31, 2016 |
| Cash and cash equivalents | $ 10,772 | $ 25,189 |
| Accounts receivable | 59,170 | 49,969 |
| Derivative asset | – | 39 |
| Note receiveable | 1,864 | – |
| Lease receivable | 3,908 | – |
| | $ 75,714 | $ 75,197 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

The maximum exposure to credit risk for accounts receivable at the reporting date by geographic region was:

| | Carrying Amount | |
|---|---|---|
| | **December 31, 2017** | December 31, 2016 |
| Canada | $ 16,576 | $ 12,695 |
| United States | 29,520 | 22,741 |
| Mexico | 1,249 | 1,671 |
| Italy | 10,363 | 4,368 |
| India | 7,234 | 8,494 |
| | $ 64,942 | $ 49,969 |

**Interest rate risk**

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial assets and financial liabilities with variable interest rates expose the Group to cash flow interest rate risk. Changes in market interest rates also directly affect cash flows associated with the Group's bank operating lines of credit and components of its long-term debt that bear interest at floating interest rates.

The Group manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis as well as actively monitoring interest rates. A 1% increase or decrease in interest rates as at December 31, 2017 would increase or decrease net earnings by approximately $278,000 (2016 – $354,000) respectively.

**Commodity price risk**

A large component of the Group's cost of sales is comprised of copper and steel, the costs of which can vary significantly with movements in demand for these resources and other macroeconomic factors. To manage its exposure to changes in commodity prices, the Group will enter into long-term supply contracts with certain suppliers, and from time to time will enter into forward commodity purchase contracts. As at December 31, 2017, no forward commodity purchase contracts were outstanding (2016 – none).

**Liquidity risk**

Liquidity risk is the risk that the Group will not be able to meet its obligations as they become due.

The Group manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior Management is also actively involved in the review and approval of planned expenditures.

The following are the carrying amounts and related contractual maturities of the Group's financial liabilities:

| **December 31, 2017** | Carrying amount | 1 year or less | 1-2 years | 2-5 years |
|---|---|---|---|---|
| Bank operating lines of credit | $ 27,755 | $ – | $ – | $ 27,755 |
| Accounts payable and accrued liabilities | 45,647 | 45,647 | – | – |
| | $ 73,402 | $ 45,647 | $ – | $ 27,755 |

| December 31, 2016 | Carrying amount | 1 year or less | 1-2 years | 2-5 years |
|---|---|---|---|---|
| Bank operating lines of credit | $ 36,507 | $ – | $ – | $ 36,507 |
| Accounts payable and accrued liabilities | 42,789 | 42,789 | – | – |
| | $ 79,296 | $ 42,789 | $ – | $ 36,507 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

**Reconciliation of movements of liabilities to cash flows arising from financing activities:**

The following is a reconciliation between the opening and closing balances for liabilities arising from financing activities:

| | Liabilities | Equity | | |
|---|---|---|---|---|
| | Bank Operating Lines of Credit | Share Capital | Retained Earnings | Total |
| Balance January 1, 2017 | $ 36,507 | $ 13,843 | $ 93,001 | $ 143,351 |
| Repayments of bank operating lines of credit | (8,752) | – | – | (8,752) |
| Interest payments | (1,263) | – | – | (1,263) |
| Proceeds from issue of share capital | – | 124 | – | 124 |
| Cash dividends paid | – | – | (2,809) | (2,809) |
| Total changes from financing cash flows | $ (10,015) | $ 124 | $ (2,809) | $ (12,700) |
| **Other changes** | | | | |
| Liability-related | | | | |
| Interest expense | 1,263 | – | – | 1,263 |
| Total liability-related other changes | $ 1,263 | $ – | $ – | $ 1,263 |
| Equity-related | | | | |
| Exercise of stock options | – | 19 | – | 19 |
| Total equity-related other changes | $ – | $ 19 | $ 6,154 | $ 6,173 |
| Balance December 31, 2017 | $ 27,755 | $ 13,986 | $ 96,346 | $ 138,087 |

## 27. Capital risk management

The Group's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future business development. The Group includes cash, bank operating lines, long-term debt and equity, comprising of share capital, contributed surplus and retained earnings in the definition of capital. The Group is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the year ended December 31, 2017.

The following table sets out the Group's capital quantitatively at the following reporting dates:

| | **December 31, 2017** | December 31, 2016 |
|---|---|---|
| Cash and cash equivalents | $ 10,772 | $ 25,189 |
| Bank operating lines of credit | (27,755) | (36,507) |
| Share capital | 13,986 | 13,843 |
| Contributed surplus | 2,600 | 2,605 |
| Retained earnings | 96,346 | 93,001 |
| | $ 95,949 | $ 98,131 |

For the years ended December 31, 2017 and 2016 (tabular amounts in thousands of dollars, except share and per share amounts)

## 28. Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the Notes specific to that asset or liability.

### (a) Derivatives

The fair value of forward exchange contracts is based on valuations obtained from third parties, based on observable market inputs.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and counterparty when appropriate.

### (b) Non-derivative financial assets

The fair value of the non-derivative financial assets recognized in connection with the disposal of the VPI product line and determined for disclosure purposes is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

### (c) Share-based payment transactions

The fair value of the employee share options is measured using the Black-Scholes model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

The fair value of DSUs is determined in accordance with the DSU Plan, which uses the average closing price for HPS shares for the five trading days immediately preceding the relevant date.

### (d) Investment property

The fair value of the investment property is based on available market evidence.

## 29. Subsequent events

### Dividends

On March 1, 2018, the Company declared a quarterly cash dividend of six cents ($0.06) per Class A subordinate voting shares of HPS and a quarterly cash dividend of six cents ($0.06) per Class B common shares of HPS payable on March 22, 2018 to shareholders of record at the close of business on March 15, 2018. The ex-dividend date is March 13, 2018.

### Purchase of Minority Interest

On January 10, 2018, the terms and conditions under an agreement to acquire the remaining 15% economic interest of Hammond Power Solutions Private Limited from a minority shareholder, which included the mutually agreed upon resignation from the Board of the minority shareholder, at a discounted amount of 76,933,000 INR (approximately $1,511,000 Canadian dollars) were fulfilled, resulting in the Company's equity ownership in Hammond Power Solutions Private Limited becoming 100%.

Canada
Hammond Power Solutions Inc.

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Delta Transformers Inc.

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Hammond Power Solutions Private Limited

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Hammond Power Solutions S.A. de C.V.

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Guadalupe, Nuevo Leon, C.P. 67190
Monterrey, Mexico

Ave. Avante #900
Parque Industrial Guadalupe
Guadalupe, Nuevo Leon, C.P. 67190
Monterrey, Mexico

Mexico
Corefficient, S. de R.L. de C.V.

Ave. Avante #840
Parque Industrial Guadalupe
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C.P. 67190

United States
Hammond Power Solutions, Inc.

1100 Lake Street
Baraboo, Wisconsin 53913

17715 Susana Road
Compton, California 90224

**ANNUAL GENERAL MEETING**

Shareholders are cordially invited to attend the Annual General Meeting held:
Wednesday May16, 2018
1:00 p.m. (EST)

Cutten Fields
190 College Avenue East
Guelph, Ontario N1H 6L3
(The Cutten Room)

## Corporate Officers and Directors

William G. Hammond *
Chairman of the Board and
Chief Executive Officer

Chris R. Huether
Corporate Secretary and
Chief Financial Officer

Donald H. MacAdam *+
Director

Douglas V. Baldwin *+
Director

Grant C. Robinson *+
Director

David J. FitzGibbon *+
Director

Dahra Granovsky *+
Director

Fred M. Jaques *+
Director

Richard S. Waterman *+
Director

* Corporate Governance Committee
+ Audit and Compensation Committee

## Stock Exchange Listing

Toronto Stock Exchange (TSX)
Trading Symbol: HPS.A

## Registrar and Transfer Agent

Computershare Investor Share
Services Inc.
100 University Avenue
Toronto, Ontario
Canada M5J 2Y1

## Auditors

KPMG LLP
115 King Street South
Waterloo, Ontario N2J 5A3

## Legal Representation

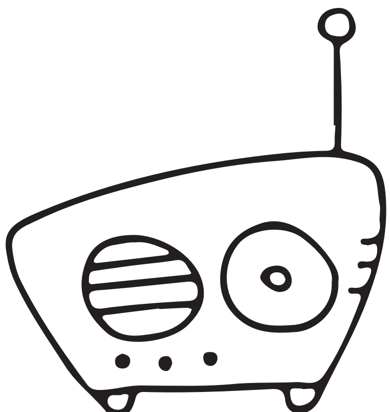
Borden Ladner Gervais LLP
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, Ontario
Canada M5H 4E3

## Banking Institution

JP Morgan Chase
Bank N.A. 66 Wellington Street West,
Suite 4500
Toronto, ON M5K 1E7

## Investor Relations

Contact: Dawn Henderson,
Manager Investor Relations
Phone: 519.822.2441
Email: ir@hammondpowersolutions.com



**The Hammond Museum of Radio** is one of North America's premiere wireless museums. It is home to thousands of receivers and transmitters dating back to the turn of the century. The museum is open regular business hours Monday
to Friday; evenings and weekends by special appointment.

Tours can be arranged by calling:
519-822-2441 x590


Hammond Power Solutions Inc.
WHAT YOU PLANT NOW,
YOU WILL HARVEST LATER.
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