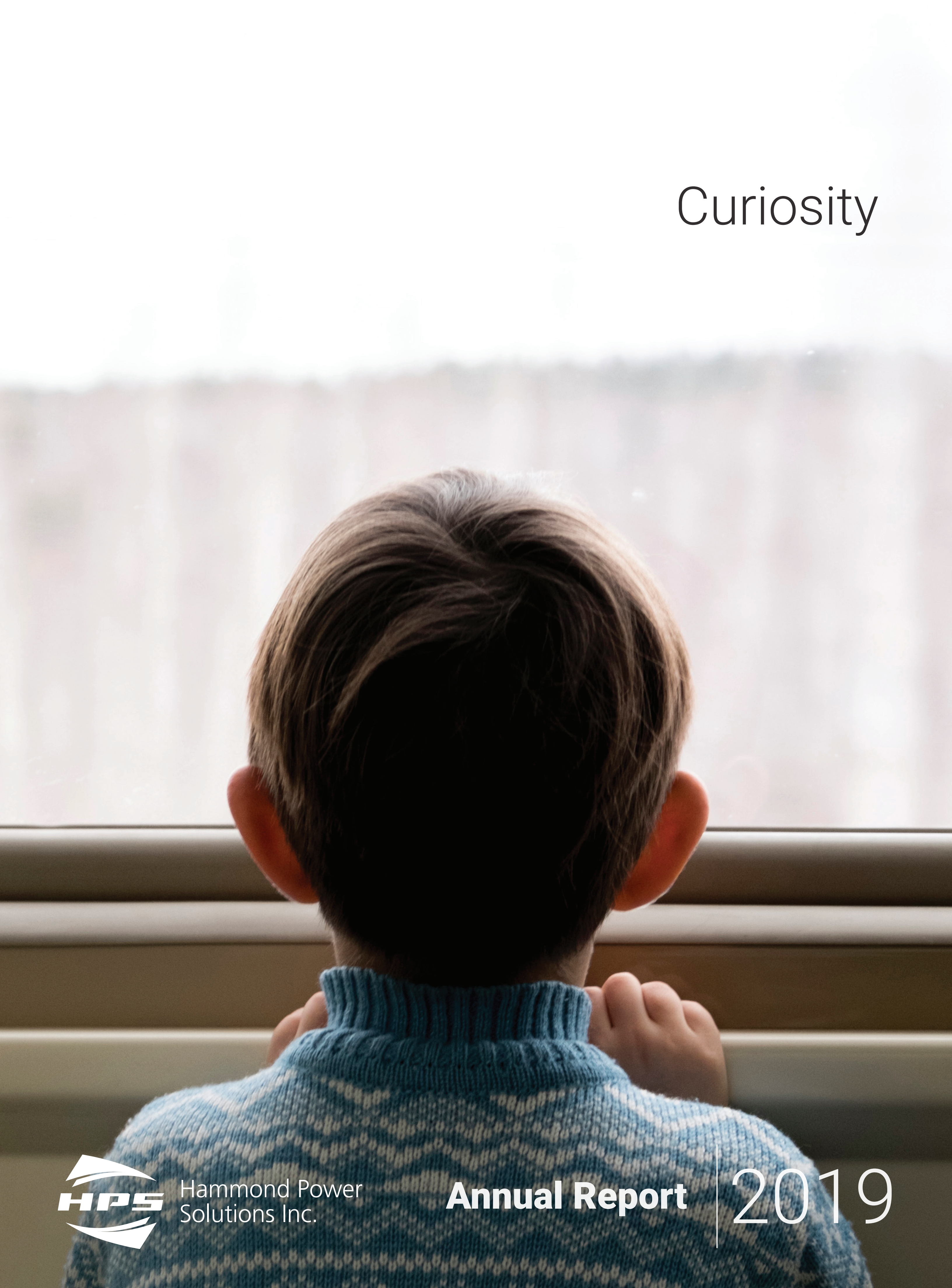
Curiosity



Hammond Power Solutions Inc.

Annual Report 2019

"We keep moving forward, opening new doors and doing new things, because we're curious and curiosity keeps leading us down new paths."

– Walt Disney

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**

Curiosity – the basis for growth and change

In 1917, Oliver Hammond a tool and die maker as well as a part-time inventor, formed O.S. Hammond and Son and began the manufacture of foundry and motor parts. Always experimenting, Oliver and his sons were curious with the new technology of radio broadcasting and began to build tube radio receivers. In 1927, they moved away from radios and began building one of the components that went into them – transformers. It was their initial curiosity that planted the seed for the next 100 years.

Like our forefathers, we continue to be curious. Curiosity allows us to think more deeply and rationally, finding more creative solutions to the challenges that we face – it's the difference between stagnation and continuous improvement. A curious organization is able to challenge its current ways, improve and adapt to the ever-changing business environment.

Curiosity – moving us to challenge, improve and adapt

The modern world needs the continuous and safe flow of electricity into our daily lives. Without transformers, there is no electricity – no power. Transformers move life forward and as pioneers in the industry, we feel an obligation to continue playing our crucial role.

Transformer design and manufacturing is accountable to the evolving global energy and efficiency regulations through improved performance. The world is changing. Renewable resources such as wind and solar power are replacing more traditional forms of energy generated through power plants. Applications such as electric mobility are gaining in popularity and are having an effect on our current distribution networks. Smart grids and the impact of automated processes enabled by the internet of things (IOT) propel our industry into a new era of transformer design.

Many companies get caught in the paradox of hitting numbers now, versus improving sales for future years ahead. We will continue to stay curious as we move forward with continual and consistent financial performance and a sustainable return to our shareholders.

Utilities and solar power generation

To our shareholders,

I am pleased to report that Hammond Power Solution Inc. ("HPS") had one of the best years of financial performance since the creation of the Company in 2001.

2019 was a stellar year in so many ways. HPS outpaced its industry peers in terms of sales growth while increasing our gross margins and net income at impressive rates compared to the previous year. We delivered this industry leading growth without expanding our physical manufacturing footprint, while maintaining high customer service levels. All of this was accomplished through the dedicated support and flexibility of our employees in all of our North American facilities. We also have our distributors and customers to thank for the value and trust they continue to place in HPS.

2019 was not only a year of delivering strong financial and operational results, it was also a year focused on strategic planning and concentrating on how we will continue to build a strong future for our Company. Just over 12 months ago, we made the decision to close our last European manufacturing facility and subsequently incur the substantial financial costs to do so. A very difficult decision, but necessary in our minds to immediately improve the financial performance of HPS and in doing so, reduce our net debt and improve our balance sheet. This not only better prepares HPS for potential economic risks, but also positions us well for growth opportunities in the years ahead.

HPS is now one of the largest dry-type transformer companies in the world. As we gear up for the decade ahead we know there is always room for improvement. We will work diligently to be an industry leader and to be the best transformer supplier for our distributors and our Original Equipment Manufacturers ("OEM") customers. 2019 was a great year, with very positive sales growth, very positive margin growth, excellent production and capacity coordination, very positive ship on-time results, cost of quality results and health and safety results.

We still see many opportunities for growth in the renewable energy markets, through market share and geographical expansion, as well as the possibility of growth through acquisition. Regardless of our success however, we will remain guarded and prepare as best we can to weather the global economic and geo-political shocks which have become a normal part of being in business today.

We are pleased to say we are stronger than we have ever been and we believe in what will be a bright future for HPS, its shareholders, employees, customers and suppliers.

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

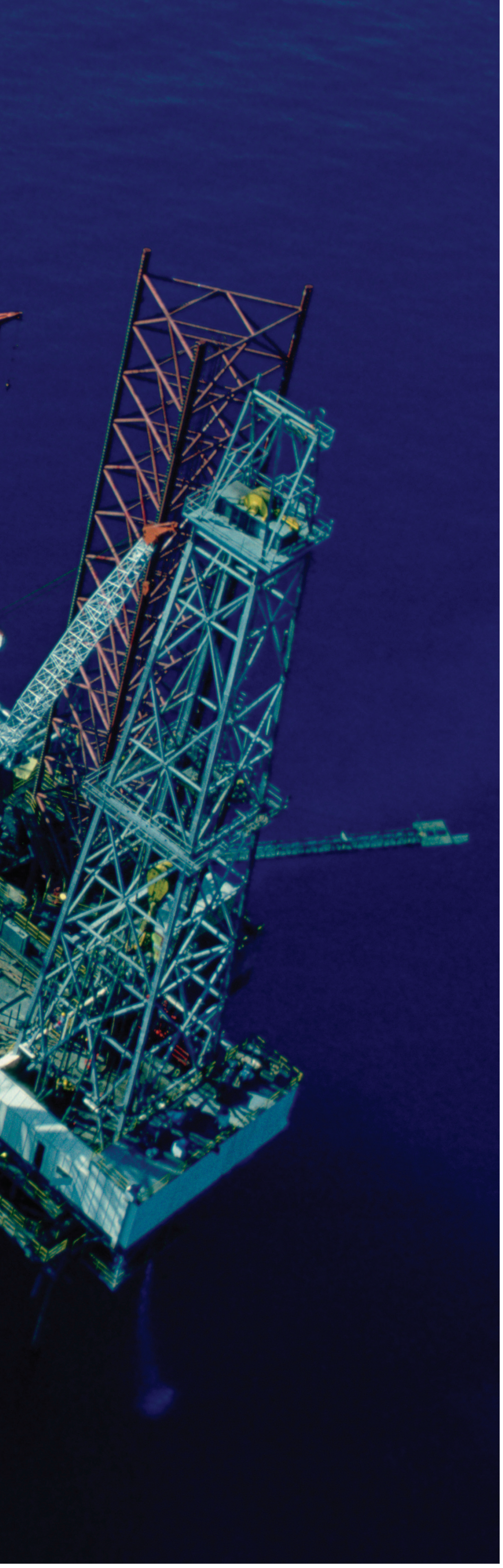
■ Commercial Infrastructure

Strategic Accomplishments

HPS has undergone significant growth and expansion over the past few years:

- Industry leading sales in Canada and United States
- Escalating growth of the NAED channel
- Increased gross margin rate
- Expanded relationships with existing customers
- Growth through strategic acquisition
- New global customers
- Compliance with regulatory changes
- New product development
- Expanded product offering using cast resin technology
- Capital investment in North American manufacturing facilities in Canada, the U.S. and Mexico
- Establishment of a state-of-the-art core manufacturing facility in Mexico
- Development and further implementation of our ERP system to enhance availability of information and streamline processes

Offshore drilling



Competitive and Strategic Advantage

HPS is focusing on the following growth strategies:

- Investing in capital and its employees
- Disciplined cost management initiatives
- Sales development
- NAED channel expansion
- Broadened product offering
- Strong organic growth
- Diversity of markets and products – easiest to do business with;
- Product development
- Capital and investment
- Strategic planning
- Bringing quality and value to all stakeholders of the Company

Financial Strength

HPS maintains financial strength through:

- Solid profits and EBITDA
- Strong Balance Sheet
- Low debt levels
- Low stock price to net book value
- Cash generator
- Attractive yield – growing dividend

Petro-chemical

North American Distributor Channel

HPS continues to realize growth in the North American market through its strong NAED and OEM channels. We are growing our market share through distributor conversions and its custom transformer capabilities. The expansion of these segments is also a result of expanded product offerings, organic customer diversity, new customer additions and geographically diverse manufacturing capabilities.

Our largest engine of growth is our U.S. distributor channel – our bigger and better network of national and independent distributors has helped us increase our market share over the last five years and more good things are expected going forward.

Manufacturing Diversity

HPS has taken advantage of the North America flexibility that we have with seven manufacturing facilities in Canada, the U.S. and Mexico which has allowed us to strategically move product as needed to fill under-utilized capacity without investing in new manufacturing space. Higher levels of productivity along with the cooperation of our employees to work additional hours as required, helped significantly. As a result, we were able to produce in excess of $50 million Canadian more from our North American operations in 2019 as compared to 2018.

Enterprise Resource Planning (ERP)

The implementation of our ERP system has allowed HPS to enhance the availability and quality of information accessible to support operational performance, strategic decision making and audit and control. This system has been implemented in the majority of our North American facilities and our HPS India operation.

Our Quebec based operation began implementation in late 2019 and is scheduled for completion in mid-2020. The consolidation to the ERP platform is an important step towards providing one global, integrated, consistent source of information and data.

Internet data and IOT technology

A Review of Operations

We are very pleased to present our 2019 results and reflect back on a successful year of accomplishments and financial performance.

Ensuring a stellar year of financial results in many ways began with a difficult decision to close our last European plant located in Marnate, Italy, at the end of 2019. As noted in previous reporting, HPS struggled to turn our European operations around following a precipitous drop in business in 2013. In an attempt to become profitable in a slow and very competitive market, we consolidated manufacturing from two plants into one in 2013 and changed our management team.

When recovery was proceeding much slower than required and we were faced with projections of losing money in 2019 and beyond, in 2018 we resolved to exit this business and absorb the financial repercussions. In doing so, we knew that our corporate profitability would improve significantly given how European losses were detracting from the excellent performance of our North American business. We also knew that the improved profitability of the Company resulting from this action would help to reduce our debt as well as our risks going into a period of global economic uncertainty. I am pleased to report that all of this fell into place in 2019.

HPS has been on a very positive momentum of sales and profit growth in North America that began in 2017. As mentioned, the magnitude of this was masked by our financial challenges in Europe. In 2019 we delivered the second-best financial results since 2001. For the second year in a row, our sales growth was top quartile in the electrical industry in both Canada and the United States ("U.S."). Much of this was attained through growth in market share, especially in the U.S.; however, at the same time we also had the biggest year of sales in Canada and in the history of HPS. Even more gratifying is the fact that this growth came in a year when the U.S. industrial market actually declined as a result of the negative effect of the U.S./China tariff war and an overall drop in North American exports due to a global economic slowdown in 2019.

Sales of both our HPS and Delta brands hit all-time highs in Canada in 2019. These two brands are dominant in Canada in terms of specification position, quality and breadth of distributor network as well as overall market share. All of this great performance is the result of hard work by both organizations and it certainly paid off in 2019. The stars seemed to align for a second consecutive year with a string of wins for both HPS and Delta as we landed sizeable commercial, public infrastructure, transit, utility and resource projects coast-to-coast. The majority of this growth came from British Columbia, Ontario and Quebec and is even more impressive with the negative effects of the continued slowdown in the Alberta energy sector.

Automated processes

For the tenth consecutive year we have increased our sales through the U.S. distributor channel and for the third year in a row this growth was double digit. We have worked hard over the last decade to expand the coverage and quality of our distributor network across the U.S. and this presence along with our broad range of standard and custom products has accelerated our market share penetration. We have focused significant time and effort on serving the needs of our customers and distributors better than any other transformer company; this covers a broad range of capabilities including ship-on-time, lead times, quality, product performance, ease of installation, on-line service, caring and helpful staff, field service support and the largest inventory of standard transformers in our industry.

During the last part of 2019, we moved our regional distribution centre from Los Angeles to a larger and more centrally located facility in Reno, Nevada. This is one of seven regional warehouses that we have around the U.S. giving us unparalleled service from stock to support our growing distributor network.

Other channels to the U.S. market place experienced a bit slower growth than expected for a variety of reasons. Many of our Original Equipment Manufacturers ("OEM") and industrial customers were adversely affected by the tariff war between the U.S. and China as well as the slowdown in the global economy which impacted exports. We also saw a cyclical slowdown in the data center business which had been very strong for a number of years. One market that remained fairly buoyant through the year was the U.S. energy market due to continuing fracking activity in various parts of the country. Unlike Canada, the U.S. energy sector has been moving ahead with pipelines to connect the various regions of the country where the oil fields are located with the oil and petrol chemical refineries on the Gulf Coast.

Our joint venture business "Corefficient" is our state-of-the-art core building located in Mexico. In 2019, the pricing and availability of offshore core steel in the U.S. was adversely affected by the imposition of tariffs on steel by the Trump Administration which became an opportunity to increase Corefficient sales in manufactured and processed cores which were not subject to these tariffs. Some of the calamity however within the U.S. transformer industry as a result of these tariffs, reduced the growth rate that was planned for in 2019, as it took these companies longer to approve and shift their business to Corefficient.

Although it may not seem apparent from our Indian results that progress was made in rebuilding this part of our organization, we did make headway during 2019. Despite hopes that the re-election of Narendra Modi as Prime

Minister would boost the Indian economy, the lead up and aftermath of the election produced the opposite. For a variety of reasons, mostly self-inflicted by the Federal Government, the Indian economy contracted in 2019. It is widespread knowledge from manufacturers and suppliers that the Indian transformer industry overall has dropped over 20% year-over-year. Unfortunately, our business has declined by a similar percentage. We have also been caught in the cross-fire between the Indian Government and the solar industry over Modi's sudden post re-election decision to cut subsidies to solar projects (already underway and in planning stages) some of which included our transformers in Southern India. The solar market had become a sizeable percentage of our sales; as a result, we have been focused on diversifying our sales in other markets and areas of India.

In 2019 we focused our attention on investing time, resources and capital, and restructuring our Indian operations under our corporate manufacturing and engineering groups. Over the last year, our North American teams have spent considerable time in India working with and sharing best practices to improve a number of business processes. These include engineering, quality control, purchasing, production-planning and sales prospecting. In 2019 we also replaced our Plant Manager and our Managing Director to assure we have the talent necessary to grow and to become one of the most favoured independent transformer companies in India. Along with this we brought our Indian operations onto our Corporate financial and ERP systems to not only improve our production and purchasing scheduling capabilities, but to also give us more timely and accurate financial information. Regardless of the setbacks in our profitability, we still believe that India holds great potential as one of the fastest growing economies in the world and a country that needs enormous expansion and modernization of their energy and public infrastructure.

During 2019, there was a determined effort overall to absorb our increased volumes without increasing our manufacturing footprint. We invested in additional equipment to expand production in our existing facilities and resisted building new plants as we have done before those recessions in 2000 and 2008.

We have taken advantage of the flexibility that we have with seven plants in Canada, the U.S. and Mexico. This has allowed us to move production when needed to fill under-utilized capacity without investing in new manufacturing space. Higher levels of productivity and the excellent flexibility and cooperation of our employees to work additional hours as needed helped significantly. As a result, we were able to produce in excess of $50 million Canadian more from our North American plants in 2019 as compared to 2018.

These higher levels of production within our existing facilities also increased our gross margins without significantly more capital investment. We could not have accomplished this without the cooperation and hard work of our employees.

This is an exciting period in the growth and evolution of Hammond Power Solutions. Like the rest of our industry, members of the Baby Boomer generation who have worked to build our company over the last 20 years, are beginning to retire. This will be the largest turnover of people in the company in over 30 years. Such a transition will give HPS the opportunity to recharge its management team with individuals who can build our business and its capabilities over the decades to come.

Over the last two years given the coming transition of our employee demographics as well as the rapidly changing nature of work, we have elevated the importance of talent development. This will require more investment in training programs and new technology than we have undertaken before. We have been mapping our current skill base so we have the right hard and soft skills for the critical roles of the future. We have also been expanding our Transform and Solutions programs to broaden the engagement of our employees in continuous improvement activities while upgrading their skills.

At the same time, we are strategically investing in our Information systems platform and digital technology to assist our employees in making informed decisions quickly. It's about empowering our people so that we are the easiest option to do business with, besting our competitors while controlling costs.

The last three years have positioned HPS more favourably for the decade ahead. The sale of our Italian operation has immediately improved our corporate profitability while reducing our global exposure to economic risks. This will also allow us to reduce our debt levels and interest costs as well as build a war chest for future acquisition opportunities if the right one presents itself.

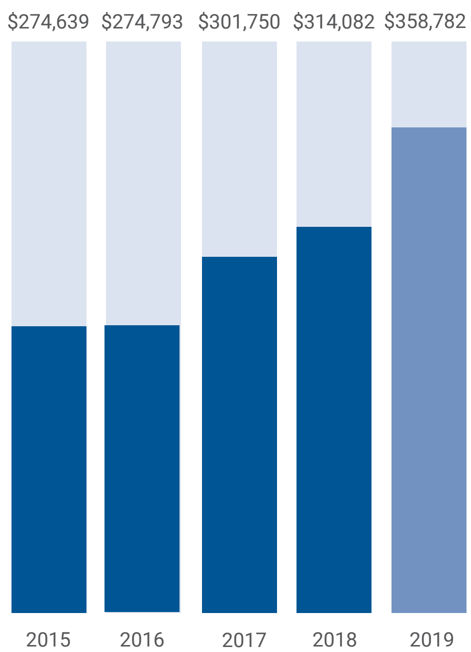
Over the last ten years we have built HPS into the dominant dry-type transformer company in North America. We see multiple opportunities to grow our sales and market share, especially in the United States. We are also planning to expand our penetration of the Mexican, Latin America and Caribbean markets in 2020 by taking advantage of the infrastructure of our three locations in Monterrey, Mexico.

In addition, we continue to be optimistic with regard to our growth prospects in India as well as parts of Africa and Asia. The economic growth and modernization opportunities in India alone present HPS with the opportunity to grow and diversify outside of North America.

Despite our tremendous success in the last year and the potential of another positive year in 2020, we are constantly reminded about the volatile political climate in the U.S. as well as growing concerns about the health of the global economy. Our greatest strength as an organization is our broad diversity in terms of geography, channels, markets and products. This diversity will help us better weather a possible economic slowdown in the next few years and also allow HPS to rebound faster when it's over.

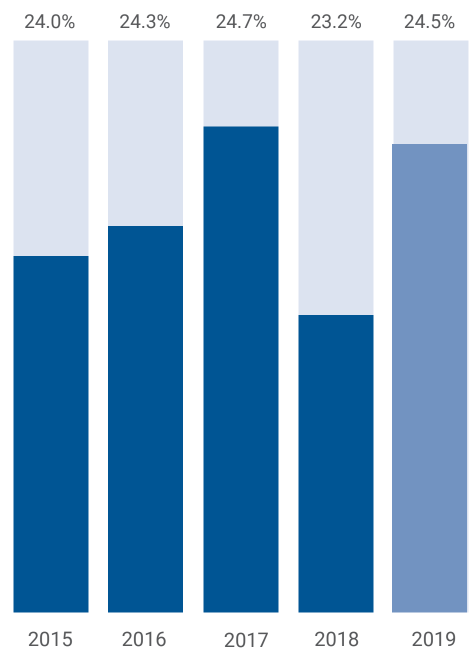
Consolidated Sales*

(in thousands of dollars)



* from continuing operations

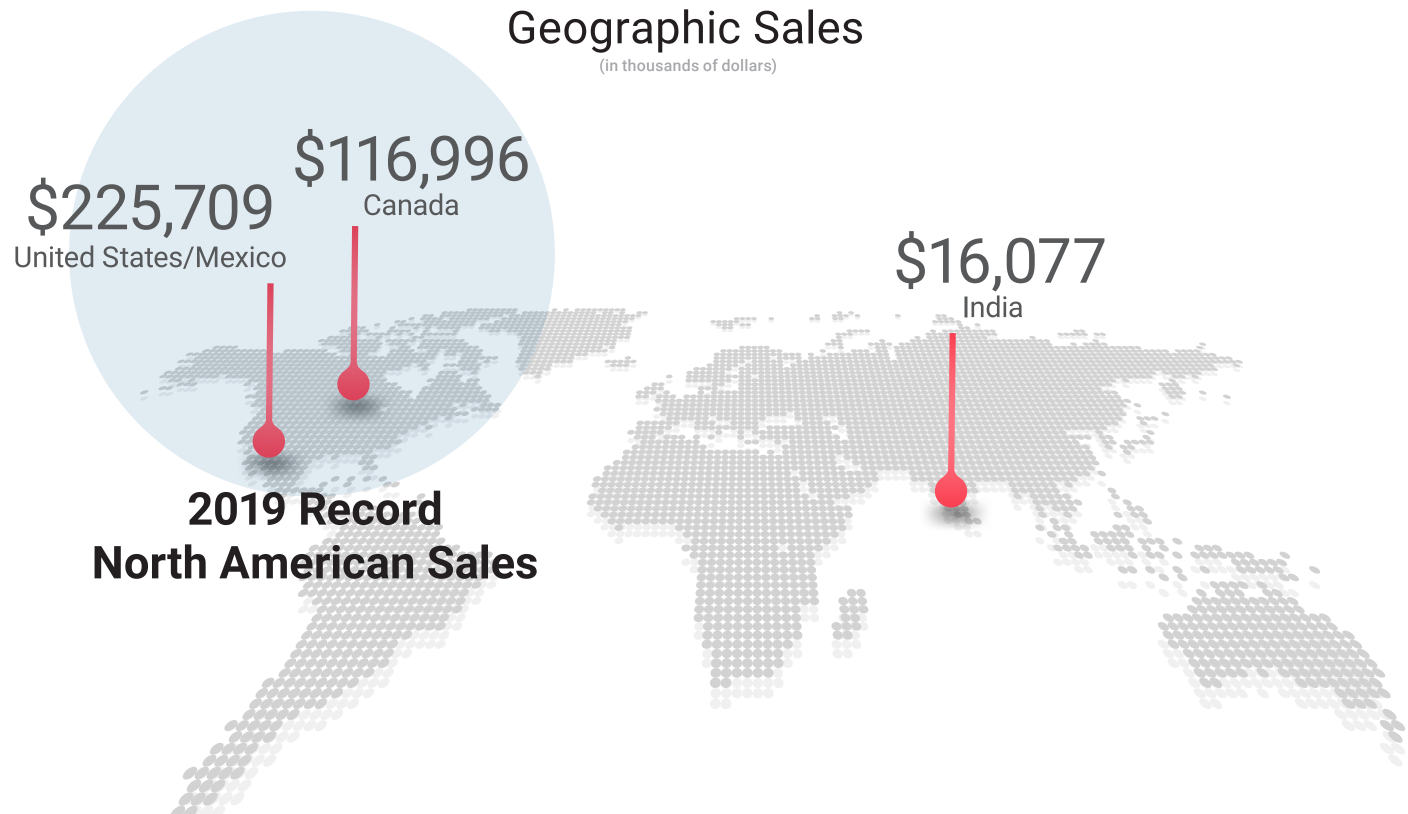
Gross Margin %*



* from continuing operations

Geographic Sales

(in thousands of dollars)

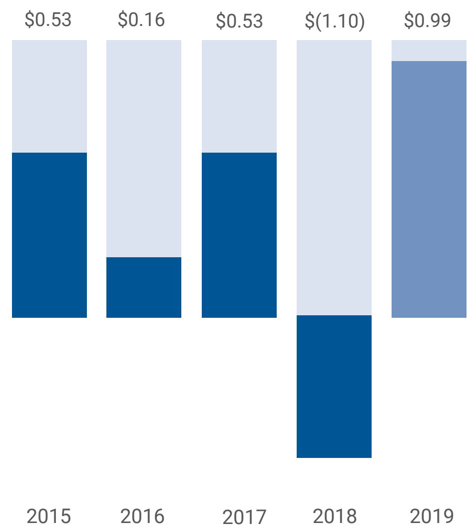


In 2019, HPS reported the highest earnings since 2011.

Earnings from Operations*
(in thousands of dollars)

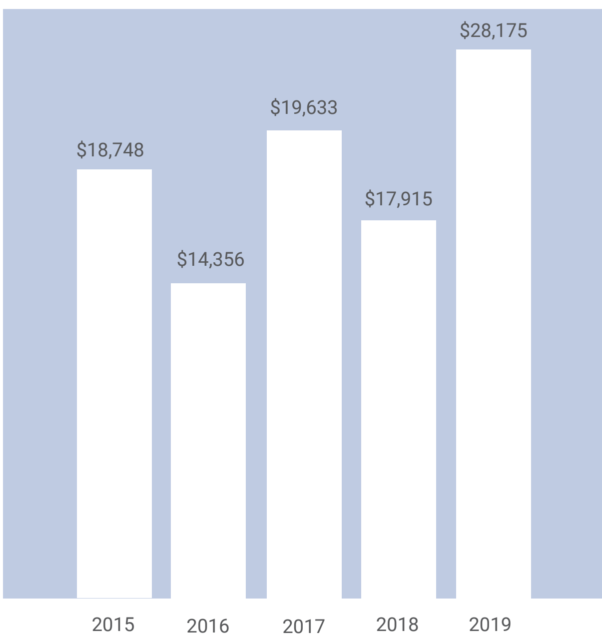
* from continuing operations

Basic Earnings (Loss)* Per Share
(in dollars)



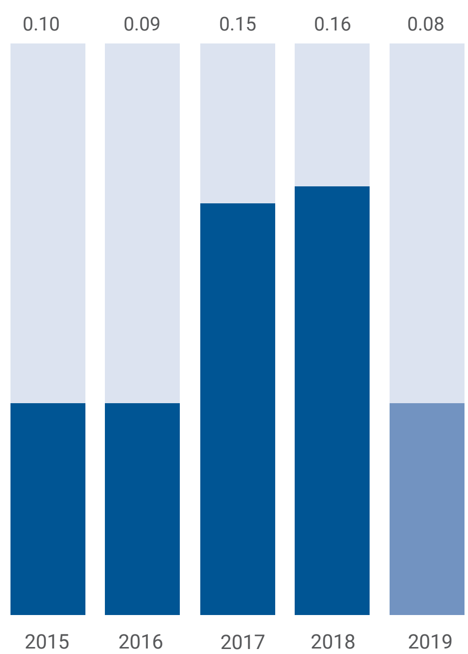
* from continuing operations

EBITDA*
(in thousands of dollars)



* from continuing operations

Debt** to Equity Ratio



** operating line drawings net of cash

Manufacturing

Management's Discussion and Analysis

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, and India.

The following is Management's Discussion and Analysis ("MD&A") of the Company's consolidated financial position and performance for the years ended December 31, 2019 and 2018, and should be read in conjunction with the accompanying Consolidated Financial Statements of the Company as at December 31, 2019 and 2018, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This information is based on Management's knowledge as at March 25, 2020. 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 from continuing operations represents EBITDA from continuing operations adjusted for 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, 2019 and December 31, 2018 is contained within this 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 2019 consolidated financial statements, which comprise the consolidated statements of financial position as at December 31, 2019 and December 31, 2018, the consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for the years ended December 31, 2019 and December 31, 2018, and Notes thereto, have been prepared under IFRS.

Overview

HPS is a transformer industry leader providing superior quality, custom engineered and standard product solutions, broad offerings and market access through multiple sales channels. The Company's alignment of its operational initiatives and strategic vision enhances these competitive differentiators. HPS has a well-established and growing market presence and a focus on continued growth through current and new customers and products.

We experienced economic and industry-leading market growth in Canada and the U.S. while international markets were unstable and unpredictable at times during 2019. HPS has begun to realize the economic benefit resulting from the discontinuance of our Italian operations.

HPS' North American sales volume continues to surge to record levels in 2019. The Company continued to escalate its North American market share growth, particularly through its North American Electrical Distributor ("NAED") channel as well as the motor control, capital equipment, switch gear, specialty transformer and maintenance, repair and operations ("MRO") markets.

HPS' success is achieved through its commitment to producing quality, innovative, energy efficient, diverse transformers and related magnetic products. The Company has a strong financial footing that allows for continued focus on market share growth. The Company's international expansion, through both acquisition and partnerships in the past few years demonstrates our commitment to sales growth, geographic expansion and product diversification. The Company's increased global footprint provided a gateway to new technologies, customers and markets. These strengths are important to future revenue and earnings growth.

The technology and knowhow obtained through acquisitions, allowed HPS to accelerate the research and development program of its cast resin transformer technology and product development which are now manufactured in several HPS facilities.Our transformer core manufacturing joint venture, Corefficient S. de R.L. de C.V. ("Corefficient"), vertically integrates our raw material supply line and provides HPS with a competitive advantage.

2019 was a most successful year financially for HPS, influenced by a number of factors that positively impacted HPS' profitability and financial performance: a stronger North American economy, solid sales and marketing strategies which supported increased organic customer sales, market share growth and increased gross margin rates combined with excellent manufacturing performance, partially offset by higher selling and distribution costs. The financial performance of Corefficient had marked improvement as the joint venture increased its revenues by further building its trade sales customer base, higher manufacturing throughput, lower material costs and increased selling prices.

In 2017, the Company restructured its Italian operations to advance its financial performance. Through the sale of the Vacuum Pressure Impregnated ("VPI") transformer product line, the Company was able to consolidate its manufacturing operations in Italy reducing excess capacity and workforce costs. Despite these efforts, the Italian operations continued to struggle to generate adequate sales and manufacturing throughput volumes for the remaining operation. As a result of the mounting financial losses the Company ceased operations and announced the closure of the Italian facility in December 2018. The decision to close the Marnate facility was a very difficult one, but necessary due to the significant mounting losses of the operation. The volatility and instability in the overall European economy, electrical market conditions, pricing pressure and lack of competitiveness were all contributing factors. The Company was able to enter into an Asset Purchase and Sale Agreement with an Italian purchasor which included the sale of the inventory, machinery and equipment and had the purchaser assume certain employee related liabilities. HPS continues to own the Marnate, Italy building, which is held as an investment property and is currently being leased to the purchasor. The results from the Italian operations are presented as discontinued operations in the 2019 and 2018 financial statements and highlight the impact the struggling Italian operations has had on HPS' performance.

HPS achieved market share growth and maintained an overall healthy financial position throughout the implementation of operational initiatives and longer-term strategic projects.

In order to deliver resilient financial performance, HPS continues to concentrate on sales growth, gross margin generation and operational improvement. Globally in the U.S., Canada 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 market presence through its product capabilities, product quality, cost effectiveness, service and geographical market expansion.

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

The Industry outlook indicates some global economic growth in many sectors yet declines in others. We are optimistic in continued market improvement into 2020, particularly in North America. HPS is cognizant of the geopolitical instability, particularly in the U.S. with the upcoming presidential election, resource-based commodity cost uncertainty, the variability of foreign currencies and the growing risks to the global economy caused by trade wars and the impacts of tariffs.

HPS remains confident in its ability to generate growth – through our strategic vision merged with our operational strategies. Management is aware of the need to plan and build for the future and is determined to proactively confront the profitability pressures presented in the market. The Company is persistent in identifying and developing new market opportunities which will come from organic and new customer sales expansion, product and technology development, cost effectiveness, competitive lead-times and manufacturing flexibility. Our capabilities are extended through our multi-national operations which provide expanded market opportunities, allowing HPS to deliver results. The Company's commitment to continuous improvement, cost reduction, improved efficiencies and overall cost effectiveness will assist in reaching these goals. These strategies will improve and build revenue and profitability trends.

The combination of a secure financial foundation, strong business fundamentals and strategic vision positions HPS for growth as well as creating 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. The Company maintains a strong and stable balance sheet and excellent liquidity supported by a committed credit facility available to implement investment strategies, operational plans and advance growth initiatives.

HPS has gained significant momentum in 2019 and is positioned well to continue to grow and execute its vision into 2020.

Sales

Sales from continuing operations in 2019 were $358,782 as compared to sales of $314,082 in 2018, a significant increase of $44,700 or 14.2%.

U.S. market sales (stated in Canadian dollars) were $225,709, an increase of $27,849, or 14.1%, compared to 2018 sales of $197,860. U.S. sales, (stated in U.S. dollars), have increased from $153,173 in 2018 to $170,073 in 2019, an increase of $16,900 or 11.0%. The U.S. market experienced significant double digit increases in the NAED market as well as growth in the specialty and machine building markets. These gains are partially offset by decreases in the motor control market.

Sales were favorably impacted by the strengthening of the U.S. dollar relative to the Canadian dollar. The average U.S. to Canadian exchange rate for 2019 was $1.327 versus $1.294 in 2018, a U.S. dollar strengthening of 2.6%.

Canadian sales were $116,996, an increase of $23,355 or 24.9% as compared to sales of $93,641 in 2018. There has been a substantial increase in the NAED market sales of 28%, strong sales in the capital equipment, switch gear and motor control markets which were somewhat offset by declines in the mining and utilities markets over the prior year.

International operations continued to struggle in 2019. Indian sales decreased $6,504 or 28.8% from $22,581 in 2018 to $16,077 in 2019. The decline in India is due to delays in projects, specifically the shipment of a state government solar project.

Stated by geographic segment, sales from continuing operations in the U.S. were 62.9% (2018 – 63.0%), Canadian were 32.6% (2018 – 29.8%) and India sales accounted for 4.5% (2018 – 7.2%) of our total sales.

The Company experienced historically high growth rates in the North American market through its established and strong NAED and OEM channels. HPS is growing its market share through distributor conversions and its custom transformer capabilities. The ability to continue to expand these segments is also a result of new customer additions, organic customer diversity, expanded product offerings and geographically diverse manufacturing capabilities. HPS is not single-market or industry dependent and our market diversification strategies provide a natural business hedge.

HPS is committed to its growth strategy through our focus on product development, innovative research and development projects, capital expenditure program to increase capacity, vertical integration strategies, business development activities and its expanded NAED network. 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 market influence.

HPS prides itself on providing value to our customers. The Company is committed to consistent quality, competitive product design, expertise in custom engineered products and product breadth. 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, 2019 bookings increased by 11.4% over the prior year. In 2019 direct sales bookings decreased by 8.4% and bookings in the distributor channel increased by 31.1%. The decrease in direct channel sales bookings was mostly attributed to lower activity in the OEM market in 2019. 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, 2019 backlog increased by 4.0% as compared to December 31, 2018, due to higher NAED bookings. The combination of the Company's expanded distributor network, strategic sales initiatives and new product offerings are expected to convert into continued strength in booking rates.

HPS is sensitive to the volatility and changeability of 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 consolidated gross margin rate from continuing operations in 2019 increased to 24.5% versus 23.2% in 2018, an increase of 1.3% of sales. The boost in margin rates is attributed to sales mix, achieved price increases, decreased commodity costs, increased manufacturing throughput and cost reductions. Margin rates can be sensitive to selling price pressures, volatility in commodity costs, customer mix and geographic blend. The Company continues to combat competitor short-sighted pricing strategies through its total value-added engineered solutions. HPS' focus during the year has been on execution of its selling price realization strategies and achievement of cost reductions in an effort to lift margin rates.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

While some growth strategies can have a shorter-term dilutive effect on gross margin rates, the Company continues to focus on the long-term investment to fuel future growth. Gross margin rates are supported by the maintenance of market prices combined with material procurement and engineering cost reduction initiatives. Increased sales volume will also contribute positively to the absorption of factory overheads from the higher manufacturing throughput, favourably lifting margin rates. HPS is currently investing in the support of future sales growth and new product development.

The quotation activity, solid backlog and positive sales outlook continue to provide optimism for the future. Looking ahead, 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 of volatility, the Company expanded its distributor footprint in North America, enlarged its Indian market presence, implemented engineering cost reduction initiatives, invested in new product development and expanded manufacturing capabilities. A diversified geographic approach supports anticipated growth from implemented market strategies and subsequent economic improvement.

HPS continues to commit resources to its continuous improvement program, which will result in implementing productivity enhancements, cost reductions and lead-time improvements across the entire organization. HPS is confident that these actions will enhance future margin rates and improve profitability and overall financial performance.

Selling and distribution expense

Total selling and distribution expenses from continuing operations were $41,476 for 2019 versus $36,003 in 2018, an increase of $5,473 or 15.2%. On a percentage-of-continuing-sales basis, total selling and distribution expense increased slightly to 11.6% of sales for 2019 from 11.5% in 2018. The increased sales for the year resulted in higher commission expense of $1,349 and higher freight expense of $1,524 which are variable selling expenses that naturally rise with higher sales and increased sales based incentive plans.

General and administrative expense

General and administrative expenses from continuing operations in 2019 were $25,940 compared to $23,153 for 2018, an increase of $2,787 or 12.0%. On a percentage-of-continuing-sales basis these costs have decreased from 7.4% in 2018 to 7.2% in 2019. The Company incurred abnormal expected credit loss provisions related to our international operations, inflationary increases, strategic hiring recruitment costs as well as increased expense in employee incentive programs.

HPS continues to invest in growth while remaining very cognizant of prudent general and administrative expense management.

Earnings from continuing operations

Earnings from continuing operations surged, finishing at $20,543 in 2019, as compared to earnings of $13,779 in 2018, an increase of $6,764 or 49.1%. The change in earnings from operations is a result of the increase in sales, higher gross margin rates and dollar contribution offset by increased selling and distribution and general and administrative expenses.

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

	2019	2018
Net earnings from continuing operations for the year	$ 13,306	$ 7,256
Add:		
Income tax expense	5,882	3,397
Finance and other costs	1,355	3,126
Earnings from continued operations	$ 20,543	$ 13,779

Net finance and other costs

Net finance and other costs have decreased $1,771 from $3,126 in 2018 to $1,355 in 2019. The majority of the change $1,811, relates to the prior year provision for the uncertainty over collectability of the note receivable partially offset by higher interest costs in 2019 related to the implementation of the new lease accounting standard.

Interest expense from continuing operations for the year-ended December 31, 2019, finished at $1,739 as compared to $1,463 in 2018, an increase of $276. During 2019 HPS implemented the accounting standard adoption of IFRS 16 for leases which was adopted without retrospective application and allocates a portion of lease costs to interest expense. This contributed to $325 of the current year increase. The offsetting decrease 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.

The foreign exchange gain from continuing operations in 2019 of $234 related primarily to the transactional exchange gain of the Company's U.S. dollar trade accounts payable in Canada, compared to a foreign exchange gain of $127 in 2018. The increase of the foreign exchange gain for the year is related to the volatility in the exchange rates during the year – primarily the U.S. dollar which increased 2.6% relative to the Canadian dollar in 2019. The ongoing volatility is managed by HPS' foreign exchange contract hedging program. Details of the outstanding forward foreign exchange contracts at December 31, 2019 can be found in note 29 in the Notes to Consolidated Financial Statements included in our 2019 Annual Report.

Earnings from continuing operations, before income tax

2019 earnings from continuing operations before income taxes was $19,188 as compared to earnings of $10,653 in 2018, growing by $8,535 or 80.1%. The main contributors to the higher current year net earnings were increased sales, gross margin rate improvement, positive foreign exchange movements, the prior year note receivable provision and improved results in the Company's joint venture partially offset by increased selling and distribution expenses.

Income taxes

Income tax expense from continuing operations for 2019 was $5,882 as compared to $3,397 in 2018, an increase of $2,485 or 73.2%. The consolidated effective tax rate on earnings from continuing operations for 2019 decreased to 30.7% versus 31.9% last year – a decrease of 1.2%. In 2019 the effective tax rate was impacted by non-deductible costs, losses for which no deferred tax asset was recognized and a basis difference in a subsidiary.

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. The Company's income tax provision is explained further in note 16 in the Notes to Consolidated Financial Statements included in our 2019 Annual Report.

Net earnings from continuing operations

Net earnings from continuing operations for 2019 finished at $13,306 compared to net earnings of $7,256 in 2018, an increase of $6,050 or 83.4%. The improvement in earnings is a result of increased sales, gross margin rate improvement, positive foreign exchange movements, the prior year note receivable provision and improved results in the Company's joint venture, partially offset by increased selling and distribution expenses.

Discontinued operations and restructuring charges

HPS executed several strategic restructuring plans to advance and expedite profitability improvement and cost competitiveness.

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. In Quarter 2, 2018, HPS continued cost reductions in the Italian location through workforce reductions and incurred restructuring charges of $560. In Quarter 4, 2018, the Company closed its Italian facility and ceased operation as the entity struggled to generate adequate sales and profits. The restructuring charges were comprised of severance and benefit costs related to workforce reductions, closure and cancellation costs and write-downs of goodwill, long-lived assets and inventory, totaling $15,925. The closure of the Italian operations has been presented as discontinued operations in the financial statements. The total net loss in Italy for 2018 was $20,173.

During 2019, the Company continued the closure process of the Italian facility and was successful in selling the machinery and equipment, inventory and certain employee related liabilities to a third party. The Asset Purchase and Sale Agreement closed in late November 2019 for a sale price of 1,086 EUR (approximately $1,583 Canadian dollars) and resulted in a loss on disposal of 471 EUR (approximately $687 Canadian dollars). Also, as a result of this transaction, 1,369 EUR (approximately $2,035 Canadian dollars) of the 2018 restructuring provision for severances that were accrued but not paid was reversed. This recovery was partially offset by additional restructuring charges totaling 897 EUR (approximately $1,307 Canadian dollars) for cancellation costs, legal fees and additional expected credit losses. These restructuring costs are included in loss from discontinued operations in the Financial Statements.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

The loss from discontinued operations for 2019 was $1,699.

EBITDA

EBITDA from continuing operations for the year-ended December 31, 2019 was $28,175 versus $17,915 in 2018, a significant increase of $10,260 or 57.3%. Adjusted for foreign exchange gains, adjusted EBITDA for 2019 was $27,941 versus $17,788 in 2018, an increase of $10,153 or 57.1%.

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

		2019		2018
Net earnings from continuing operations	$	13,306	$	7,256
Add:				
Interest expense		1,739		1,463
Income tax expense		5,882		3,397
Depreciation and amortization		7,248		5,799
EBITDA from continuing operations	$	28,175	$	17,915
Subtract :				
Foreign exchange gain		(234)		(127)
Adjusted EBITDA from continuing operations	$	27,941	$	17,788

Internet of Things (IOT) Technology

Summary of quarterly financial information (unaudited)

Fiscal 2019 Quarters	Q1	Q2	Q3	Q4	Total
Sales	$ 84,690	$ 91,937	$ 91,502	$ 90,653	$ 358,782
Net earnings	$ 2,315	$ 2,958	$ 3,123	$ 3,211	$ 11,607
Net earnings from continuing operations	$ 2,508	$ 3,352	$ 3,595	$ 3,851	$ 13,306
Net earnings per share – basic	$ 0.20	$ 0.25	$ 0.27	$ 0.27	$ 0.99
Net earnings per share – diluted	$ 0.20	$ 0.25	$ 0.27	$ 0.27	$ 0.99
Net earnings per share from continuing operations – basic	$ 0.21	$ 0.29	$ 0.31	$ 0.32	$ 1.13
Net earnings per share from continuing operations – diluted	$ 0.21	$ 0.29	$ 0.31	$ 0.32	$ 1.13
Average U.S. to Canadian exchange rate	$ 1.3301	$ 1.3379	$ 1.3198	$ 1.3203	$ 1.3270

Fiscal 2018 Quarters	Q1	Q2	Q3	Q4	Total
Sales	$ 70,397	$ 75,418	$ 81,553	$ 86,714	$ 314,082
Net earnings (loss)	$ 895	$ (370)	$ 1,391	$ (14,833)	$ (12,917)
Net earnings from continuing operations	$ 1,884	$ 1,222	$ 2,445	$ 1,705	$ 7,256
Net earnings (loss) per share – basic	$ 0.08	$ (0.03)	$ 0.12	$ (1.27)	$ (1.10)
Net earnings (loss) per share – diluted	$ 0.08	$ (0.03)	$ 0.12	$ (1.27)	$ (1.10)
Net earnings per share from continuing operations – basic	$ 0.16	$ 0.10	$ 0.21	$ 0.15	$ 0.62
Net earnings per share from continuing operations – diluted	$ 0.16	$ 0.10	$ 0.21	$ 0.15	$ 0.62
Average U.S. to Canadian exchange rate	$ 1.2618	$ 1.2895	$ 1.3072	$ 1.3185	$ 1.2943

Quarterly sales for 2019 increased from the same quarter in 2018 as a result of North American market share development through organic and new customer growth and a more robust U.S. and Canadian economy. Year-to-year quarterly fluctuations in both sales and income are affected by changes in demand, foreign exchange rates, product mix, changing economic conditions and pricing influences. The Company achieved a margin rate lift through product mix, increased manufacturing throughput and price increase execution.

Fluctuations in exchange rates resulted in a gain in foreign exchange during Quarter 4, 2019 of $154, an improvement of $59 from the prior year gain of $95. Year-to-date there was a foreign exchange gain of $234 in 2019 compared to a gain of $127 in 2018. Reduced volatility of exchange rates had a positive impact on quarterly earnings.

Corefficient realized some profitability improvement during 2019. Year-to-date earnings from the joint venture were $267 in 2019 compared to $116 in 2018. Improvement in joint venture performance was a result of elevated sales, higher manufacturing throughput, lower material costs and increased selling prices.

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

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Quarter 4, 2019 financial results

	Quarter ended December 31, 2019	Quarter ended December 31, 2018
Sales	$ 90,653	$ 86,714
Earnings from operations	$ 5,862	$ 4,780
Exchange gain	$ (154)	$ (95)
Net earnings (loss)	$ 3,211	$ (14,833)
Net earnings from continuing operations	$ 3,851	$ 1,705
Earnings (loss) per share – basic	$ 0.27	$ (1.27)
Earnings (loss) per share – diluted	$ 0.27	$ (1.27)
Earnings per share from continuing operations – basic	$ 0.32	$ 0.15
Earnings per share from continuing operations – diluted	$ 0.32	$ 0.15
Cash provided by operations	$ 16,447	$ 4,941

Sales for the quarter ended December 31, 2019 were $90,653, an increase of $3,939 or 4.5% from the comparative quarter last year, which is reflective of increased market activity and growth in market share within North America.

Quarter 4, 2019 gross margin dollars increased slightly by $3,156 compared to Quarter 4, 2018. The gross margin rate increased to 25.7% in Quarter 4, 2019 versus 23.2% in Quarter 4, 2018 as a result of sales mix and the timing of price increases.

Total selling and distribution expenses amounted to $9,924 in Quarter 4, 2019 versus $10,006 in Quarter 4, 2018, a decrease of $82 or 0.8%. Selling and distribution expenses as a percentage of sales have decreased to 10.9% in 2019 compared to 11.5% in 2018.

General and administrative expenses for Quarter 4, 2019 totaled $7,515 – an increase of $2,102 when compared to Quarter 4, 2018 costs of $5,413. Abnormal expected credit loss provisions primarily related to our international operations, strategic hiring recruitment costs as well as increased expense in employee incentive programs account for the increase. General and administrative expenses as a percentage of sales have increased to 8.3% in 2019 compared to 6.2% in 2018.

2018 net finance and other costs include $1,811, related to uncertainty over collectability of the note receivable. The Quarter 4, 2019 interest cost has increased as a result of the implementation of the accounting standard adoption of IFRS 16 for leases which allocates a portion of lease costs to interest expense which was $100 in Quarter 4, 2019.

Foreign exchange gain in Quarter 4, 2019 was $154 compared to a foreign exchange gain of $95 in Quarter 4, 2018.

In late 2018, the decision was made to close the Italian plant and cease operations, resulting in restructuring costs of $15,925. The restructuring charges were comprised of severance and benefit costs related to workforce reductions, closure and cancellation costs and write-downs of goodwill and intangible and other assets.

In Quarter 4, 2019, the Company was successful at selling the machinery and equipment, inventory and certain employee related liabilities to a third party. The Asset Purchase and Sale Agreement closed in late November 2019 for a sale price of 1,086 EUR (approximately $1,583 Canadian dollars) and resulted in a loss on disposal of 471 EUR (approximately $687 Canadian dollars). Also, as a result of this transaction, 1,369 EUR (approximately $2,035 Canadian dollars) of the 2018 restructuring provision for severances that were no longer liable was reversed. This recovery was partially offset by additional restructuring charges totaling 897 EUR (approximately $1,307 Canadian dollars) for cancellation costs, legal fees and additional expected credit loss provisions.

Earnings from operations for the quarter were positively impacted by increased sales, higher gross margin rate and lower selling and distribution expenses, offset by higher general and administrative expense. Quarter 4, 2019 earnings from operations increased $1,136 from earnings of $4,726 in Quarter 4, 2018 to earnings of $5,862 in Quarter 4, 2019.

Quarter 4, 2019 income tax expense was $1,642 on earnings before income taxes of $5,493 (an effective tax rate of 29.9%) as compared to an income tax expense of $990 on income before income taxes of $2,695 (an effective tax rate of 36.7%) in Quarter 4, 2018 – an increase of $652. The lower effective tax rate in 2019 was primarily the result of the 2018 non-deductible restructuring charges recorded at Hammond Power Solutions S.p.A. ("HPS Italy") and no recognition of the tax benefit of losses.

Net income for Quarter 4, 2019 was $3,211 compared to net loss of $14,833 in Quarter 4, 2018, an improvement of $18,044.

Cash provided by operations for Quarter 4, 2019 was $16,447 versus $4,941 in Quarter 4, 2018, an increase of $11,506. An increase in the cash generated from operations was due primarily to the higher income for the quarter. Non-cash working capital generated by operations increased from cash used of $10 in Quarter 4, 2018 to cash generated of $7,926 in Quarter 4, 2019.

Overall operating debt balance, net of cash, was $9,326 as at December 31 2019, a decrease of $7,730 as compared to a net debt balance of $17,056 as at December 31, 2018, primarily reflecting improved profitability and cash generated from operations.

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 2019 was $17,810 versus $6,474 in 2018, an increase in cash generated of $11,336. This increase in cash generated from operating activities was due to higher net income. Non-cash working capital used cash of $6,374 in 2019 versus $5,552 in 2018, resulting in an increase of $822 from 2018. The change in non-cash working capital for 2019 was primarily a result of decreases in accounts receivable and provisions offset by increases in inventory and foreign exchange adjustments.

Accounts receivable finished the year at $64,004 as compared to $69,010 as at December 31, 2018, a decrease of $5,006 – a result of higher collections in Quarter 4 2019 compared to Quarter 4, 2018. 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 $50,926 as at December 31, 2019, versus $48,636 as at December 31, 2018, an increase of $2,290. The higher inventory levels in 2019 were attributed to a buildup of inventory to satisfy a predicted increase in 2020 sales volume.

Accounts payable and accrued liabilities increased by $119 finishing at $53,890 as at December 31, 2019, compared to $53,711 at the end of 2018. The change in accounts payable is related to the timing of purchases from and payments to suppliers.

Net income taxes receivable were $571 (income taxes receivable of $1,626 less income taxes payable of $1,055) as at December 31, 2019, versus net income taxes receivable of $506 (income taxes receivable of $953 less income taxes payable of $447) as at December 31, 2018, a change of $65.

Cash used in financing activities was $7,393 in 2019, compared to cash generated of $759 in 2018, a change of $8,152. The change in the balance can be attributed to higher advances from bank operating lines in 2018, compared to 2019, higher dividend payments and payment of leases liabilities in the current year of $2,431.

Cash used in investing activities in 2019 decreased $383 from $3,351 in 2018 to $2,968 in 2019, a result of a current year contribution to the joint venture, higher purchases of property plant and equipment. These uses of cash are offset by the cash received in the amount of $1,583 from the sale of the Italian assets. There was an increase in capital spending for property, plant and equipment of $1,794 over the prior year, totaling $3,682 in 2019 – compared to $1,888 for 2018. Expanded manufacturing capacity and new product development continue to be areas of capital expenditure spending. In addition there was operational maintenance capital invested at all facilities and manufacturing product mandated projects. In addition, the Company used cash in the amount of $1,511 in 2018 to facilitate the purchase of a minority shareholder's remaining interest in the Indian operation.

Bank operating lines of credit finished the year at $32,697 as at December 31, 2019, compared to $32,601 as at December 31, 2018 resulting in a small increase of $96 in the year.

Overall operating debt balance, net of cash, was $9,326 as at December 31 2019, a decrease of $7,730 as compared to a net debt balance of $17,056 as at December 31, 2018, primarily reflecting improved profitability and cash generated from operations.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

All bank covenants were met as at December 31, 2019, and the Company was in compliance with its covenants throughout the year.

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 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 outstanding capital expenditure commitments of $80 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 27 in the Notes to Consolidated Financial Statements contained in our 2019 Annual Report.

Credit agreement

The Company's current credit agreement consists of a $40,000 U.S. revolving credit facility and a $10,000 U.S. delayed draw credit facility. The revolving borrowing can be comprised of U.S. Prime Borrowings, Canadian Prime Borrowings, CDOR Borrowings, or LIBOR Borrowings. This agreement 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 2020, 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 375,000 INR, consisting of a 131,000 INR short-term working capital demand loan facility and a 244,000 INR bank guarantee and letters of credit facility.

Based on exchange rates in effect at December 31, 2019, the combined Canadian dollar equivalent available prior to any utilization of these facilities was $77,737.

The Company's current credit agreement matures in June 2021.

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.

	2020	2021	2022	2023	2024 & Thereafter	Total
Accounts payable and accrued liabilities	$ 54,824	–	–	–	–	$ 54,824
Capital expenditure purchase commitments	80	–	–	–	–	80
Operating lines of credit	–	32,697	–	–	–	32,697
Derivative liability	1,392	–	–	–	–	1,392
Lease liabilities	2,237	2,111	2,217	1,730	3,109	11,404
Total	$ 58,533	$ 34,808	$ 2,217	$ 1,730	$ 3,109	$ 100,397

Hammond Power Solutions S.p.A. – Italy

As part of the VPI asset sale 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 from the Company for consideration equal to 2,225 Euros. The plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375 Euros (approximately $563 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 Euros (approximately $750 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 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.

Management is not aware of any contingent liabilities.

Regular quarterly dividend

The Board of Directors of HPS declared a 16.7% increase in the quarterly cash dividend to seven cents ($0.07) per Class A Subordinate Voting Share of HPS and of seven cents ($0.07) per Class B Common Share of HPS.

The Quarter 1 dividend was paid on March 26, 2019 to shareholders of record at the close of business on March 19, 2019 – the ex-dividend date was March 25, 2019. The Quarter 2 dividend was paid on June 18, 2019 to shareholders of record at the close of business on the 11th day of June 2019 – the ex-dividend date was June 16, 2019. The dividend for Quarter 3 was paid on September 27, 2019 to shareholders of record at the close of business on September 20, 2019 – the ex-dividend date was September 25, 2019. The Quarter 4 dividend was paid on December 11, 2019 to shareholders of record at the close of business on December 4, 2019 – the ex-dividend date was December 9, 2019.

In 2019, the Company has paid a total cash dividend of twenty-eight cents ($0.28) per Class A Subordinate Voting Share and twenty-eight cents ($0.28) per Class B Common Share.

Normal course issuer bid

On November 5, 2018, the Board of Directors of the Corporation authorized the repurchase of up to 50,000 Class A Subordinate Voting Shares by way of a normal course issuer bid through the facilities of the TSX. Daily purchases will be limited to 1,318 Class A Subordinate Voting Shares, other than block purchase exceptions, which is 25% of the average daily trading volume of Class A Subordinate Voting Shares of HPS on the TSX in the preceding six calendar months. The purchases commenced on November 9, 2018 and were terminated on November 8, 2019. Purchases were made in open market transactions on the TSX. During 2019, 40,800 shares were repurchased and 2018, 9,200 shares were repurchased totaling the approved amount of 50,000 shares. The normal course issuer bid was completed in Quarter 3, 2019.

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, 2019, 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, 2019 such disclosure controls and procedures were operating effectively.

The Company aggressively bolstered its internal controls of the operation, including the implementation of the Enterprise Resource Planning System ("ERP") system and additional third party audits.

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 2019, which was completed in the fourth quarter.

As of December 31, 2019 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, 2019.

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

During 2019 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 6, 2020, the Company declared a 21% increase in its quarterly cash dividend. The dividend declared was eight and a half cents ($0.085) per Class A subordinate voting shares of HPS and a quarterly cash dividend of eight and a half cents ($0.085) per Class B common shares of HPS payable on March 26, 2020 to shareholders of record at the close of business on March 19, 2020. The ex-dividend date is March 18, 2020.

COVID-19

On March 11, 2020, the World Health Organization declared the global outbreak of the Coronavirus, COVID-19, a pandemic. The extent of the impact COVID-19 will have on the operations and financial results of the Company in fiscal 2020 is currently not known with certainty.

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 marketplace, 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 70% 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 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.

Coronavirus (COVID-19) – Business Disruption

Markets, governments and health organizations around the world are working to contain the outbreak of the coronavirus (COVID-19). COVID-19 presents a wide range of potential issues or complications for the Company, most of which the Company is not able to know the full extent of.

The following is a summary of what the Company believes may impact their business as a result of COVID-19:

- Disruptions to business operations resulting from quarantines of employees, customers, suppliers and third party service providers in areas affected by the outbreak; and
- Disruptions to business operations resulting from travel restrictions.
- Uncertainty around the duration of the virus' impact.

At this time, it is unclear as to whether COVID-19 represents a material disruption to the Company's business.

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. HPS' 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 us. HPS' 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 HPS 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 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. This risk is partially mitigated by managements credit policy under which each new customer is analysed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group's review includes external ratings, if they are available, financial statements, credit agency information, industry information and in some cases bank references. Sale limits are established for each customer and reviewed quarterly. Any sales exceeding those limits require approval from Executive management. 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 capital commitments disclosed in note 15 in the Notes to the Consolidated Financial Statements contained in our 2019 Annual Report.

Transactions with related parties

The Company had transactions with related parties in 2019, as disclosed in note 25 in the Notes to the Consolidated Financial Statements contained in our 2019 Annual Report.

Proposed transactions

The Company had no proposed transactions as at December 31, 2019. 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, 2019, the Company had outstanding foreign exchange contracts in place for 17,200 EUR, $12,000 USD and 330,000 INR – which were implemented as an economic hedge against translation gains and losses on inter-company loans and $52,000 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, 2018 for 16,200 EUR and $11,000 USD and 130,000 INR as economic hedges against translation gains and losses on inter-company loans and $45,000 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 29 in the Notes to the Consolidated Financial Statements contained in our 2019 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, 2019, are as follows:

8,966,624	Class A Shares
2,778,300	Class B Common Shares
11,744,924	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

New accounting pronouncements adopted during the period

Leases

On January 13, 2016 the IASB issued IFRS 16, Leases, which became effective for the Company's annual and interim financial statements commencing for the period beginning January 1, 2019.

Under this standard, the Group recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate or the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Group has applied judgement to determine the lease term for some leases in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right of use assets recognized.

Previously, the Group classified property and equipment leases as operating leases under IAS 17. At transition, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate at January 1, 2019. A right-of-use asset was recognized at January 1, 2019 at an amount equivalent to its carrying amount as if IFRS 16 had been applied since the commencement of the lease, but discounted using the Company's incremental borrowing rate of 3.0% at the date of initial application.

The Company has elected to apply the following accounting policy exemptions:

- Grandfather the assessment of which transactions are leases. It applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered into or changed on or after January 1, 2019.
- Not recognize right-of-use assets and lease liabilities for contracts that have a lease term of 12 months or less.
- Not recognize right-of-use assets and lease liabilities for leases of low-value assets (under $5,000).
- Excluded initial direct costs from measuring the right-of-use asset at the date of initial application.
- Apply a single discount rate to the portfolio of leases with reasonably similar characteristics.
- Using hindsight when determining the lease term if the contract contains options to extend or terminate the lease.

The modified retrospective approach was applied when implementing this standard. This approach calculated the lease assets and lease liabilities and recognized an equity adjustment at January 1, 2019 and does not restate prior-period financial information. The Group recorded a right-of-use asset for the Company's premises and other leases in the amount of $9,058,000, a corresponding lease obligation of $11,657,000, a related future tax asset of $639,000 and an adjustment to retained earnings of $1,960,000. Effective January 1, 2019, amounts which previously would have been characterized as rent expense for these leases are now included in the Statement of Operations as depreciation and interest expense. Comparative amounts have not been restated.

At December 31, 2019 the right-of-use asset was $9,053,000 and the corresponding lease obligation of $11,404,000. Further details regarding the Company's lease asset and liabilities are disclosed in note 14 in the Notes to the Consolidated Financial Statements contained in our 2019 Annual Report.

New accounting pronouncements to be adopted

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.

Definition of a Business (Amendments to IFRS 3)

On October 22, 2018, the IASB issued amendments to IFRS 3 Business Combinations that seeks to clarify whether a transaction results in an asset or a business acquisition. The amendments apply to businesses acquired in annual reporting periods beginning on or after January 1, 2020. Earlier application is permitted.

The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition of substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or as a group of similar identifiable assets. If the preparer chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The Company intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2020. The Company does not expect the adoption of the Amendments to have a material impact on the consolidated financial statements.

Strategic direction and outlook

HPS has undergone significant growth and expansion over the past few years:

- Escalating growth of the NAED channel;
- New global customers;
- Expanded relationships with existing customers;
- Compliance with regulatory changes;
- New product development;
- Expanded product offering using cast resin technology;
- Capital investment in North American manufacturing facilities in Canada, the U.S. and Mexico;
- Establishment of a state-of-the-art core manufacturing facility in Mexico; and
- Development and further implementation of our ERP system to enhance availability of information and streamline processes.

Hammond Power Solutions has a history of strength, perseverance and resilience. We have navigated through difficult and fluctuating economic times, increased globalization, adapted to changes in customers and markets and have experienced significant advances in technology. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes – while continuing to grow and expand.

The implementation of our ERP system has allowed HPS to enhance the availability and quality of information accessible to support operational performance, improve customer service, supplement strategic decision making and audit and control. The ERP system implementation was completed in our Indian facility in Quarter 2, 2019 and an implementation project began in Quarter 3, 2019 for the Company's remaining operation that will be converted to our ERP platform. It is expected to be fully implemented in late 2020. The consolidation to the ERP platform is an important step towards providing one global, integrated, consistent source of information and data.

At the end of 2018 the decision was made to close the Italian facility and cease operations due to low sales volume and inability to cover fixed costs related to these operations. The closure resulted in restructuring charges and the presentation of the Italian operations as discontinued. Subsequently as part of the closure, HPS signed a Sale and Purchase Agreement to sell the machinery and equipment and inventory to a competitor.

HPS has modern manufacturing facilities throughout the world and this continues to be enhanced through our committed capital investment. Our Mexico based joint venture, Corefficient, is evidence of investing in the future, in both technology and capacity, which enhances our competitiveness. The joint venture generated a profit in 2019 as a result of increased volumes and adjusting pricing structures and improved profitability is expected to continue to progress going forward.

HPS continues to focus on customer service and growth – expanding existing relationships as well as exploring new opportunities. Past regulatory requirements to comply with the U.S. Department of Energy ("DOE") regulations and the upcoming Canadian efficiency standard changes ("NRCan") has created opportunities for us 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.

HPS is aware that the global economy is vital to maintaining competitiveness and market share growth. The International expansion into India and Italy has allowed HPS 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.

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

HPS is confronting these challenges and continuously building our competitive and strategic advantage by focusing on:

- Investing in capital and our employees;
- Disciplined cost management initiatives;
- Sales development;
- NAED channel expansion;
- Broadened product offering;
- Bringing quality and value to all stakeholders of the Company;
- Cash flow generation;
- Product development;
- Capital investment; and
- Strategic planning.

These strengths position HPS to meet the evolving and dynamic needs of our traditional markets while becoming a leading player in a number of growing market sectors. Our diverse products, loyal customers and targeted markets are critical to generating future sales growth.

HPS continues to have a strong reputation of being an industry leader and is both operationally and financially strong. HPS is well positioned to meet the evolving needs of both our traditional markets while becoming a leading player in a growing number of other market sectors. We continue to be focused on escalation of market share, improved sales growth from new product development, geographic diversification, productivity gains, cost reduction and capacity flexibility.

HPS' strategic vision and operational initiatives have supported our industry leadership, operational strength and financial stability. The combination of our resilience, drive, decades of experience, commitment, engineering expertise, solid supplier relationships and a broad and unique business perspective gained through our diverse products, customers and markets are all key success factors critical to our success.

HPS will deliver solid financial performance, provide a sustainable return to our shareholders, maintain Balance Sheet strength and deliver long-term value to all stakeholders.

Selected Annual and Quarterly Information

(tabular amounts in thousands of dollars)

Annual Information [1]	2015	2016	2017	2018	2019
Sales	274,639	274,793	301,750	314,082	358,792
Earnings from operations	12,644	10,873	14,470	13,779	20,543
EBITDA	18,748	14,356	23,069	17,915	28,175
Net earnings (loss)	6,320	1,793	6,114	(12,917)	11,607
Total assets	222,969	205,177	192,449	205,527	214,953
Non-current liabilities	5,454	4,131	3,641	2,528	11,271
Total liabilities	90,668	84,524	77,438	96,793	105,186
Total shareholders' equity attributable to equity holders of the Company	129,665	120,441	114,848	108,734	109,767
Operating debt, net of cash	(13,202)	(11,318)	(16,983)	(17,056)	(9,326)
Cash provided by operations	16,065	15,216	1,032	6,474	17,810
Basic earnings (loss) per share	0.53	0.16	0.53	(1.10)	0.99
Diluted earnings (loss) per share	0.53	0.16	0.52	(1.10)	0.99
Dividends declared and paid	2,807	2,808	2,809	2,818	3,287
Average exchange rate (USD$=CAD$)	1.274	1.325	1.298	1.294	1.327
Book value per share	11.08	10.29	9.80	9.26	9.36

	2018				2019			
Quarterly Information	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	70,397	75,418	81,553	86,714	84,690	91,937	91,502	90,653
Earnings from operations	2,752	3,028	3,219	4,780	4,479	4,731	5,471	5,862
EBITDA	3,631	2,184	3,879	8,221	6,111	7,111	7,302	7,651
Net earnings (loss)	895	(370)	1,391	(14,833)	2,508	3,352	3,595	2,152
Total assets	197,187	202,635	200,954	205,527	206,554	205,059	206,586	214,953
Non-current liabilities	3,429	3,383	3,291	2,528	10,914	10,558	9,947	11,271
Total liabilities	77,829	83,210	83,253	96,793	99,939	99,640	96,870	105,186
Total shareholders' equity attributable to equity holders of the Company	119,358	119,425	117,701	108,734	106,615	105,419	109,716	109,767
Operating debt, net of cash	(21,483)	(21,578)	(20,502)	(17,056)	(16,588)	(18,582)	(22,678)	(9,326)
Cash (used) provided by operations	(1,907)	972	2,468	4,941	2,316	507	(1,460)	16,447
Basic earnings (loss) per share	0.08	(0.03)	0.12	(1.27)	0.20	0.25	0.27	0.27
Diluted earnings (loss) per share	0.08	(0.03)	0.12	(1.27)	0.20	0.25	0.27	0.27
Dividends declared and paid	704	704	704	706	822	821	821	823
Average exchange rate (USD$=CAD$)	1.262	1.290	1.307	1.319	1.330	1.338	1.320	1.320
Book value per share	10.18	10.16	10.02	9.26	9.09	8.99	9.33	9.36

(1) Balances for 2015-2017 not restated to reflect discontinued operations

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.

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

Christopher R. Huether
Corporate Secretary
& Chief Financial Officer

March 25, 2020

To the Shareholders of Hammond Power Solutions Inc.

Opinion

We have audited the consolidated financial statements of Hammond Power Solutions Inc. ("the Entity"), which comprise:

- the consolidated statements of financial position as at December 31, 2019 and December 31, 2018
- the consolidated statements of operations for the years then ended
- the consolidated statements of comprehensive loss for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies (Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***"Auditors' Responsibilities for the Audit of the Financial Statements"*** section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Emphasis of Matter – Modified Retrospective Change in Accounting Policy

We draw attention to Note 3 to the financial statements which indicates that the Entity has changed its accounting policy for leases, as a result of the adoption of IFRS 16, Leases, and has applied that change using the modified retrospective approach.

Our opinion is not modified in respect of this matter.

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information, other than the financial statements and the auditors' report thereon, included in a document entitled "Annual Report 2019".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis and the Annual Report 2018, filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants,
Licensed Public Accountants
The engagement partner of the audit resulting in this auditors report is R. Alexander Dilts

March 25, 2020
Waterloo, Canada

Consolidated Statements of Financial Position

(in thousands of dollars)	As at December 31, 2019	December 31, 2018
Assets		
Current assets		
Cash and cash equivalents	$ 23,371	$ 15,545
Accounts receivable (note 4)	64,004	69,010
Inventories (note 5)	50,926	48,636
Income taxes receivable	1,626	953
Prepaid expenses and other assets (note 6)	2,657	4,082
Total current assets	142,584	138,226
Non-current assets		
Long-term lease and note receivable (note 7)	3,180	3,604
Property, plant and equipment (note 8 and note 14)	32,468	29,038
Investment in properties (note 9)	3,709	1,044
Investment in joint venture (note 10)	13,428	13,302
Deferred tax assets (note 16)	1,944	1,042
Intangible assets (note 11)	6,331	7,310
Goodwill (notes 11 and 12)	11,309	11,961
Total non-current assets	72,369	67,301
Total assets	$ 214,953	$ 205,527
Liabilities		
Current liabilities		
Bank operating lines of credit (note 13)	$ 32,697	$ 32,601
Accounts payable and accrued liabilities (notes 17 and 29)	56,216	54,326
Income taxes payable	1,055	447
Provisions (note 21)	1,710	6,891
Current portion of lease liabilities (note 14)	2,237	–
Total current liabilities	$ 93,915	$ 94,265
Non-current liabilities		
Provisions (note 21)	285	396
Deferred tax liabilities (note 16)	1,819	2,132
Long-term portion of lease liabilities (note 14)	9,167	–
Total non-current liabilities	11,271	2,528
Total liabilities	$ 105,186	$ 96,793
Shareholders' Equity		
Share capital (note 17)	14,491	14,217
Contributed surplus	2,498	2,559
Accumulated other comprehensive income	7,439	12,740
Retained earnings	85,339	79,218
Total shareholder's equity	109,767	108,734
Commitments (note 15)		
Subsequent events (note 32)		
Total liabilities and shareholders' equity	$ 214,953	$ 205,527

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 Operations

Years ended December 31, 2019 and 2018 (in thousands of dollars except for per share)

		2019		2018 (recast – Note 2(a))
Sales (note 22)	$	358,782	$	314,082
Cost of sales (note 5)		270,823		241,147
Gross margin		87,959		72,935
Selling and distribution		41,476		36,003
General and administrative		25,940		23,153
		67,416		59,156
Earnings from operations		20,543		13,779
Finance and other costs				
Interest expense		1,739		1,463
Foreign exchange gain		(234)		(127)
Share of income of investment in joint venture, net of tax (note 10)		(267)		(116)
Provision for loss on note receivable (note 7)		–		1,811
Other		117		95
Net finance and other costs		1,355		3,126
Earnings before income taxes		19,188		10,653
Income tax expense (recovery) (note 16):				
Current		6,425		4,768
Deferred		(543)		(1,371)
		5,882		3,397
Net earnings from continuing operations	$	13,306	$	7,256
Loss from discontinued operations, net of tax (note 23)		(1,699)		(20,173)
Net earnings (loss)		11,607		(12,917)
Earnings per share (note 18)				
Basic earnings (loss) per share	$	0.99	$	(1.10)
Diluted earnings (loss) per share	$	0.99	$	(1.10)
Basic earnings per share from continuing operations	$	1.13	$	0.62
Diluted earnings per share from continuing operations	$	1.13	$	0.62

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income (Loss)

Years ended December 31, 2019 and 2018 (in thousands of dollars)

	2019	2018
Net earnings (loss)	$ 11,607	$ (12,917)
Other comprehensive income		
Items that will be recognized within profit and loss:		
Foreign currency translation differences for foreign operations	(7,456)	9,492
Foreign currency translation differences for discontinued operations	2,155	1,323
Other comprehensive (loss) income, net of income tax	(5,301)	10,815
Total comprehensive income (loss)	$ 6,306	$ (2,102)

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Years ended December 31, 2019 and 2018 (in thousands of dollars)

	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON-CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance as at January 1, 2018	$ 13,986	$ 2,600	$ 1,916	$ 96,346	$ 163	$ 115,011
Total comprehensive income for the period						
Net loss	–	–	–	(12,917)	–	(12,917)
Other comprehensive loss						
Foreign currency translation differences related to joint venture (note 10)	–	–	1,028	–	–	1,028
Foreign currency translation differences	–	–	9,787	–	–	9,787
Total other comprehensive income	–	–	10,815	–	–	10,815
Total comprehensive loss for the period	–	–	10,815	(12,917)	–	(2,102)
Transactions with owners, recorded directly in equity						
Non-controlling interest (note 19)	–	–	9	(1,357)	(163)	(1,511)
Dividends to equity holders (note 17)	–	–	–	(2,818)	–	(2,818)
Stock options exercised (note 17)	245	(38)	–	–	–	207
Repurchase of shares (note 17)	(14)	(3)	–	(36)	–	(53)
Total transactions with owners	231	(41)	9	(4,211)	(163)	(4,175)
Balance at December 31, 2018	$ 14,217	$ 2,559	$ 12,740	$ 79,218	$ –	$ 108,734
Impact of application of new accounting standard (note 3(S))	–	–	–	(1,960)	–	(1,960)
Adjusted balances as of January 1, 2019	14,217	2,559	12,740	77,258	–	106,774
Total comprehensive income (loss) for the period						
Net income	–	–	–	11,607	–	11,607
Other comprehensive loss						
Foreign currency translation differences related to joint venture (note 10)	–	–	(869)	–	–	(869)
Foreign currency translation differences	–	–	(4,432)	–	–	(4,432)
Total other comprehensive loss	–	–	(5,301)	–	–	(5,301)
Total comprehensive income for the period	–	–	(5,301)	11,607	–	6,306
Transactions with owners, recorded directly in equity						
Dividends to equity holders (note 17)	–	–	–	(3,287)	–	(3,287)
Stock options exercised (note 17)	339	(49)	–	–	–	290
Repurchase of shares (note 17)	(65)	(12)	–	(239)	–	(316)
Total transactions with owners	274	(61)	–	(3,526)	–	(3,313)
Balance at December 31, 2019	$ 14,491	$ 2,498	$ 7,439	$ 85,339	$ –	$ 109,767

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

Consolidated Statements of Cash Flows

Years ended December 31, 2019 and 2018 (in thousands of dollars)

	2019	2018
Cash flows from operating activities		
Net (loss) earnings	$ 11,607	$ (12,917)
Adjustments for:		
Share of income of investment in joint venture	(267)	(116)
Depreciation of property, plant and equipment and right-of-use assets	6,151	4,438
Amortization of intangible assets	1,097	1,361
Write down of goodwill, property, plant and equipment, intangible assets and inventory (notes 5, 8, 11 and 12)	–	9,693
Write down of note receivable (note 7)	–	1,811
Gain on disposal of property, plant and equipment	–	(5)
Provisions	(132)	7,068
Interest expense	1,745	1,423
Loss on disposition (note 23)	687	–
Income tax expense	5,882	3,397
Unrealized loss (gain) on derivatives	2,997	(1,897)
Share-based compensation expense	364	109
	30,131	14,365
Change in non-cash working capital (note 27)	(6,374)	(5,552)
Cash generated from operating activities	23,757	8,813
Income tax paid	(5,947)	(2,339)
Net cash provided from operating activities	17,810	6,474
Cash flows from investing activities		
Investment in joint venture (note 10)	(728)	–
Purchase of non-controlling interest (note 19)	–	(1,511)
Proceeds on disposal of property, plant and equipment	1,583	117
Repayment of note and lease receivable	182	397
Acquisition of property, plant and equipment	(3,682)	(1,888)
Acquisition of intangible assets	(323)	(466)
Cash used in investing activities	(2,968)	(3,351)
Cash flows from financing activities		
Proceeds from issue of share capital	290	207
Cash dividends paid	(3,287)	(2,818)
Net advances of bank operating lines of credit	96	4,846
Share repurchase (note 17)	(316)	(53)
Interest paid	(1,745)	(1,423)
Payment of lease liabilities (note 14)	(2,431)	–
Cash (used in) generated by financing activities	(7,393)	759
Foreign exchange on cash and cash equivalents held in a foreign currency	377	891
Increase in cash and cash equivalents	7,826	4,773
Cash and cash equivalents at beginning of period	15,545	10,772
Cash and cash equivalents at end of period	$ 23,371	$ 15,545

See accompanying Notes to Consolidated Financial Statements.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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 and India, the latter being Hammond Power Solutions Private Limited, a subsidiary in which the Company now holds 100% 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 25, 2020.

Certain prior year amounts have been adjusted on the statements of operations due to the correction of an immaterial misstatement. The misstatement related to the presentation of interest expense in the amount of $849,000 between discontinued and continuing operations. The misstatement had no impact on the net earnings (loss) in the current or prior period. As a result, previously reported interest expense in the amount of $614,000 has been adjusted to $1,463,000 and the previously reported loss from discontinued operations, net of tax, has been adjusted from $(21,022,000) to $(20,173,000). Previously reported basic and diluted earnings per share from continuing operations in the amount of $0.69 have been adjusted to $0.62 and previously reported basic and diluted loss per share from discontinued operations in the amount of ($1.79) have been adjusted to ($1.72).

(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	($)
United States	U.S. dollar	($ USD)
Mexico	Mexican Peso	(Pesos)
Mexico – Corefficient	U.S. dollar	($ USD)
Italy	Euro	(EU €)
India	Rupee	(INR)

(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(g) and 3(k); 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.

Initial lease term

The Group leases certain manufacturing facilities, warehouse facilities, vehicles and other assets. In determing the value of a right-of-use asset and lease liability, IFRS 16 requires the Group to determine the lease payments to be made over the initial term fo the lease, including renewal options which are reasonably certain to be exercised. Such payments are then discounted based on the interest rate implicit in the lease or the Group's incremental borrowing rate. In determining the initial lease term, Management makes an assessment of the renewal periods available to the Group within each lease and evaluates the likelihood and corresponding time horizon of available renewal options. Such assessments involve judgment and ultimately may differ from the terms of leases actually experienced.

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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

(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.

Recoverability of goodwill and intangible assets

The Group tests annually or more frequently if necessary, whether goodwill or other long-lived assets have suffered any impairment in accordance with the accounting policy provided in note 3(k). Performing 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 impairment test. For assumptions relating to 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., Hammond Power Solutions Private Limited., Continental Transformers s.r.l., and its wholly-owned subsidiary, Hammond Power Solutions S.p.A..

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

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statement of financial position when the Group becomes a party to the financial instrument or derivative contract.

The Group classifies its financial assets and financial liabilities in the following measurement categories i) those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss) and ii) those to be measured at amortized cost. The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at fair value through profit or loss (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are either recorded in profit or loss or other comprehensive income.

The Group reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

The Group has applied the following classifications:

- Cash and cash equivalents, accounts receivable, and long-term lease and note receivable are classified as assets at amortized cost and are measured using the effective interest rate method. Interest income is recorded in the consolidated statement of operations, as applicable.
- Accounts payable, accrued liabilities and bank operating lines of credit are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the consolidated statement of operations, as applicable.
- Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged and the type of hedge relationship designated. The Group has not historically designated such items as hedging instruments and accordingly changes in fair value are recorded through the statement of operations.

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods.

The Group assesses all information available, including, on a forward-looking basis, the expected credit losses associated with its assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. To assess whether there is a significant increase in credit risk, the Corporation compares the risk of a default occurring on the asset as at the reporting date with the risk of default as at the date of initial recognition based on all information available, and reasonable and supportive forward-looking information. For trade receivables only, the Corporation applies the simplified approach as permitted by IFRS 9 which requires expected lifetime losses to be recognized from initial recognition of receivables.

(c) Cash and cash equivalents

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

(d) 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. 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.

(e) 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.

(f) 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.

(g) Goodwill

Acquisitions 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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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 costs to sell. 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 conducting sensitivity analyses. The discount rate used approximates the CGUs weighted average cost of capital, with business risk incorporated into the development of the cash flow projections.

An impairment loss in respect of goodwill is never subsequently reversed. The Group completed its annual goodwill impairment tests at December 31, 2019.

(h) 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.

In a period in which a change of use of a property occurs such that it becomes an investment property, depreciation ceases and its then carrying value becomes its cost.

(i) 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 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.

(j) 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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

(k) 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 reporting 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.

(l) Share-based payment transactions

Stock Option Plan

The Group has a stock-based compensation plan, which is described in note 17. 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 Company 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.

(m) 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. A restructuring provision relating to a sale or termination of a line of business, the closure of business locations in a country or region, changes in management structure or fundamental reorganizations that have a material effect of the nature or focus of the Group's operations are recognized when the Group has a detailed, formal plan for the restructuring that identifies:

- the business or part of a business concerned;
- the principal locations affected;
- the location, function and approximate number of employees affected;

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

- the expenditures that will be undertaken; and
- when the plan will be implanted.

Notwithstanding the above, no provision is recorded until such time a valid expectation by those affected by the plan has been raised.

(n) Revenue

Effective January 1, 2018, the Group adopted IFRS 15, Revenues from Contracts with Customers. IFRS 15 introduces a 5-step approach when recognizing revenue:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the Group satisfies a performance obligation.

Under IFRS 15, the Group recognizes revenue when (or as) a performance obligation is satisfied, i.e. when "control" of the goods or services underlying the particular performance obligation is transferred to the customer. A performance obligation represents a good and service (or a bundle of goods or services) that is distinct or a series of distinct goods or services that are substantially the same. The Group typically satisfies its performance obligation upon shipment of its transformers. Any required testing or compliance requirements will have been satisfied prior to shipment of the transformer. Payment is typically due within 30 days of shipment, with limited customers being granted extended terms of up to 60 days, and consideration is generally fixed and does not contain any significant financing components. The Group has a return policy for credit on standard stocked items and no custom build product can be returned. Historically returns have been minimal and are expected to continue to remain low. The Group's product is purchased with a standard warranty and there is no option to purchase any additional warranty coverage.

A contract asset represents the Group's right to consideration in exchange for goods or services that the Group has transferred to a customer that is not yet unconditional. In contrast, a receivable represents the Group's unconditional right to consideration, in that only the passage of time is required before payment of that consideration is due.

A contract liability represents the Group 's obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer.

Incremental costs to obtain a contract are typically short-term in nature and the Group applies the practical expedient permitted under IFRS 15 to recognize such costs as an expense when incurred if the amortization of the asset that the Group would have otherwise recognized is less than one year.

(o) 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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

(p) Employee benefits

The Group maintains a defined contribution and a defined benefit plan, which are described in note 20, 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.

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.

(q) Finance income and finance costs

Finance income and finance costs comprise interest income, interest expense on borrowings, foreign currency losses (including changes in fair value of derivative foreign currency financial instruments measured at fair value through profit and loss), the Group's share of income or losses arising from its investment in joint ventures and other finance costs.

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

(r) 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.

(s) New accounting pronouncements adopted during the period

Leases

On January 13, 2016 the IASB issued IFRS 16, Leases, which became effective for the Company's annual and interim financial statements commencing for the period beginning January 1, 2019.

Under this standard, the Group recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate or the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Group has applied judgement to determine the lease term for some leases in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right of use assets recognized.

Previously, the Group classified property and equipment leases as operating leases under IAS 17. At transition, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate at January 1, 2019. A right-of-use asset was recognized at January 1, 2019 at an amount equivalent to its carrying amount as if IFRS 16 had been applied since the commencement of the lease, but discounted using the Company's incremental borrowing rate of 3.0% at the date of initial application.

The Company has elected to apply the following accounting policy exemptions:

- Grandfather the assessment of which transactions are leases. It applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered into or changed on or after January 1, 2019.
- Not recognize right-of-use assets and lease liabilities for contracts that have a lease term of 12 months or less.
- Not recognize right-of-use assets and lease liabilities for leases of low-value assets (under $5,000).
- Excluded initial direct costs from measuring the right-of-use asset at the date of initial application.
- Apply a single discount rate to the portfolio of leases with reasonably similar characteristics.
- Using hindsight when determining the lease term if the contract contains options to extend or terminate the lease.

The modified retrospective approach was applied when implementing this standard. This approach calculated the lease assets and lease liabilities and recognized an equity adjustment at January 1, 2019 and does not restate prior-period financial information. The Group recorded a right-of-use asset for the Company's premises and other leases in the amount of $9,058,000, a corresponding lease obligation of $11,657,000, a related future tax asset of $639,000 and an adjustment to retained earnings of $1,960,000. Effective January 1, 2019, amounts which previously would have been characterized as rent expense for these leases are now included in the Statement of Operations as depreciation and interest expense. Comparative amounts have not been restated.

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 Group adopted the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The adoption of the Interpretation did not have a material impact on the consolidated financial statements.

(t) 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.

Definition of a Business (Amendments to IFRS 3)

On October 22, 2018, the IASB issued amendments to IFRS 3 Business Combinations, that seeks to clarify whether a transaction results in an asset or a business acquisition. The amendments apply to businesses acquired in annual reporting periods beginning on or after January 1, 2020. Earlier application is permitted.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or as a group of similar identifiable assets. If the preparer chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The Company intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2020. The Company does not expect the adoption of the Amendments to have a material impact on the consolidated financial statements.

4. Accounts receivable

	December 31, 2019	December 31, 2018
Trade accounts receivable	$ 60,589	$ 64,119
Other receivables	3,415	4,891
	$ 64,004	$ 69,010

Trade accounts receivable is presented net of expected credit losses of $2,997,000 (December 31, 2018 - $2,481,000).

A continuity of the Group's allowance for doubtful accounts is as follows:

	December 31, 2019	December 31, 2018
Opening balance	$ 2,481	$ 1,961
Additional allowances	379	724
Writeoffs	(116)	(108)
Adjustments	253	(96)
	$ 2,997	$ 2,481

5. Inventories

	December 31, 2019	December 31, 2018
Raw materials	$ 20,974	$ 22,145
Work in progress	2,276	2,799
Finished goods	27,676	23,692
	$ 50,926	$ 48,636

Raw materials and changes in finished goods, and work in progress recognized as cost of sales during the year amounted to $271,475,000 (2018 – $247,990,000), of which $1,461,000 (2018 – $7,965,000) is included in discontinued operations. In addition, during the year, reversal of write-downs in the amount of $24,000 were recognized (2018 – write downs of $677,000), of which $nil (2018 – $609,000) is included in discontinued operations. Inventories carried at net realisable value as at December 31, 2019 were $1,190,000 (December 31, 2018 – $740,000).

6. Prepaid and other assets

	December 31, 2019	December 31, 2018
Prepaid expenses	$ 2,440	$ 2,056
Derivative asset	–	1,793
Current portion of long-term lease and note receivable (note 7)	217	233
	$ 2,657	$ 4,082

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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 1,158,000 Euros (approximately $1,687,000 Canadian dollars). Concurrent with the disposal of the VPI product line, the Group entered into a lease agreement ("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, to 2023. Consideration was in the form of a lease receivable, which the Company has determined meets the definition of a finance lease.

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.

As at December 31, 2019 consideration receivable consists of:

	December 31, 2019	December 31, 2018
Lease receivable of 2,332 EUR (2018 – 2,454 EUR), with monthly lease payments of 13 EUR, bearing interest of 1.15% per annum.	$ 3,538	$ 4,018
Gross cash entitlement:		
Less: unearned finance income	(141)	(181)
Net lease receivable	3,397	3,837
Note receivable of 1,158 EUR, repayment schedule of 1,158 due immediately non-interest bearing, secured by the property, plant and equipment of the VPI business (2018 – note receivable of 1,158 EUR repayment schedule of 496 EUR due immediately, 662 EUR due October 31, 2019, non-interest bearing, secured by the property, plant and equipment of the VPI business)	1,687	1,811
Less: allowance for doubtful accounts	(1,687)	(1,811)
	$ 3,397	$ 3,837
Less current portion included within prepaid and other assets	217	233
	$ 3,180	$ 3,604

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

2020	217
2021	217
2022	217
2023	2,746
	$ 3,397

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. The put and call options expire November 23, 2023.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

8. Property, plant and equipment

Property, plant and equipment compromise owned and leased assets that do not meet the definition of investment property. Carrying amounts of owned and right-of-use assets are as follows:

	December 31, 2019	December 31, 2018
Property, plant and equipment owned	$ 23,415	$ 29,038
Right-of-use assets (note 14)	9,053	–
	$ 32,468	$ 29,038

Cost	Land	Building	Leaseholds & Improvements	Machinery & Equipment	Office Equipment	Construction In Progress	Total
Balance at January 1, 2018	$ 4,868	$ 20,902	$ 1,347	$ 56,119	$ 10,449	$ 232	$ 93,917
Additions	–	181	46	1,254	363	44	1,888
Disposals	–	–	–	(224)	–	–	(224)
Effect of movements in exchange rates	24	124	127	1,809	160	–	2,244
Balance at December 31, 2018	$ 4,892	$ 21,207	$ 1,520	$ 58,958	$10,972	$ 276	$ 97,825
Balance at January 1, 2019	$ 4,892	$ 21,207	$ 1,520	$ 58,958	$ 10,972	$ 276	$ 97,825
Additions	–	140	95	2,089	511	847	3,682
Disposals	–	–	–	(7,513)	(19)	–	(7,532)
Transfer to investment property (note 9)	(583)	(3,179)	–	–	–	–	(3,762)
Effect of movements in exchange rates	(77)	(444)	(33)	(506)	(389)	–	(1,449)
Balance at December 31, 2019	$ 4,232	$ 17,724	$ 1,582	$53,028	$ 11,075	$ 1,123	$ 88,764
Accumulated Depreciation							
Balance at January 1, 2018	$ –	$ 10,045	$ 1,094	$ 41,191	$ 9,311	$ –	$ 61,641
Depreciation for the year	–	1,044	116	2,919	359	–	4,438
Disposals/Impairment	–	457	–	498	–	–	955
Effect of movements in exchange rates	–	23	107	1,487	136	–	1,753
Balance at December 31, 2018	$ –	$ 11,569	$ 1,317	$ 46,095	$ 9,806	$ –	$ 68,787
Balance at January 1, 2019	$ –	$ 11,569	$ 1,317	$ 46,095	$ 9,806	$ –	$ 68,787
Depreciation for the year	–	969	103	2,777	435	–	4,284
Disposals	–	–	(257)	(5,974)	(45)	–	(6,276)
Transfer to investment property (note 9)	–	(1,097)	–	–	–	–	(1,097)
Effect of movements in exchange rates	–	(91)	(30)	(62)	(166)	–	(349)
Balance at December 31, 2019	$ –	$ 11,350	$ 1,133	$ 42,836	$ 10,030	$ –	$ 65,349
Carrying amounts							
At December 31, 2018	$ 4,892	$ 9,638	$ 203	$ 12,863	$ 1,166	$ 276	$ 29,038
At December 31, 2019	$ 4,232	$ 6,374	$ 449	$ 10,192	$ 1,045	$ 1,123	$ 23,415

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Depreciation is recorded in the statement of earnings as follows: cost of sales $3,357,000 (2018 – $3,494,000), selling and distribution $5,000 (2018 – $9,000), general and administrative $319,000 (2018 – $274,000) and discontinued operations $603,000 (2018 – $661,000).

During 2018, as a result of the closure of the operations of Hammond Power Solutions S.p.A., an impairment charge of $457,000 related to the building and $610,000 related to the machinery and equipment was recorded and included in discontinued operations. See note 24.

9. Investment in properties

	December 31, 2019	December 31, 2018
Glen Ewing Property	$ 1,044	$ 1,044
Marnate Property	2,665	–
	$ 3,709	$ 1,044

Glen Ewing Property

The Group has a 50% ownership interest in a property in Georgetown, Ontario, (referred to as the Glen Ewing Property). It is a vacant plot of land currently under environmental remediation, and no revenue was derived from it in 2019 or 2018. The property is carried at cost. The estimated fair value of the property as at December 31, 2019 is $1,150,000 (2018 – $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 $109,000 (2018 – $104,000).

Marnate Property

The Group owns a property in Marnate, Italy, (referred to as the Marnate Property). As part of the sale transaction of certain of the assets and liabilities of the Italian company, as outlined in note 23, the purchaser has leased the Marnate Property for a period of six years at an annual rental amount of 90,000 EUR. Concurrent with the change in use of the property, the Company reclassified it from an item of property, plant and equipment to an investment property, and ceased amortization effective on the commencement date of the lease. The property is carried at its net book value at the time of the transaction. The estimated fair value of the property as at December 31, 2019 is $3,321,000 (2,280,000 EUR). The fair value was determined based on independent available market evidence.

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 distributions of dividends and returns of capital from Corefficient are subject to unanimous Corefficient shareholder approval. Accordingly, the Company jointly controls Corefficient and has treated its investment 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, 2019	December 31, 2018
Cost of investment in joint venture	$ 20,032	$ 19,304
Cumulative share of loss in investment in joint venture, net of tax	(3,395)	(3,662)
Foreign currency translation differences related to the joint venture	(3,209)	(2,340)
	$ 13,428	$ 13,302

During the year the Company made an additional contribution of $728,000 (2018 – $nil) and recognized its share of the income of $267,000 (2018 – $116,000).

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Selected financial information relating to Corefficient is as follows:

	December 31, 2019	December 31, 2018
Cash	$ 4,341	$ 1,206
Trade and other receivables	11,286	8,405
Inventories	3,047	1,403
Other current assets	118	429
Total current assets	$ 18,792	$ 11,443
Non-current assets	19,697	17,545
Total assets	$ 38,489	$ 28,988
Current liabilities	$ 12,744	$ 5,070
Non-current liabilities	1,603	–
Total liabilities	$ 14,347	$ 5,070

	2019	2018
Revenue	$ 58,423	$ 33,043
Income for the year	485	211

Net income for the year ended December 31, 2019 includes depreciation and amortization expense of $2,149,000 (2018 – $1,871,000), net interest expense of $66,000 (2018 – net interest of income $87,000) and an income tax expense of $3,000 (2018 – income tax recovery of $7,000) related to Corefficient.

For the years ended December 31, 2019 and 2018 (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, 2018	$ 6,577	$ 8,953	$ 5,926	$ 21,456
Additions	–	–	466	466
Effect of movements in exchange rates	23	4	24	51
Balance at December 31, 2018	$ 6,600	$ 8,957	$ 6,416	$ 21,973
Balance at January 1, 2019	$ 6,600	$ 8,957	$ 6,416	$ 21,973
Additions	–	–	323	323
Effect of movements in exchange rates	(359)	(211)	(49)	(619)
Balance at December 31, 2019	$ 6,241	$ 8,746	$ 6,690	$ 21,677
Accumulated Amortization				
Balance at January 1, 2018	$ 1,906	$ 5,246	$ 3,138	$ 10,290
Amortization for the year	319	572	470	1,361
Impairment (note 23)	2,388	575	–	2,963
Effect of movements in exchange rates	18	11	20	49
Balance at December 31, 2018	$ 4,631	$ 6,404	$ 3,628	$ 14,663
Balance at January 1, 2019	$ 4,631	$ 6,404	$ 3,628	$ 14,663
Amortization for the year	145	487	465	1,097
Effect of movements in exchange rates	(231)	(141)	(42)	(414)
Balance at December 31, 2019	$ 4,545	$ 6,750	$ 4,051	$ 15,346
Carrying amounts				
At December 31, 2018	$ 1,969	$ 2,553	$ 2,788	$ 7,310
At December 31, 2019	$ 1,696	$ 1,996	$ 2,639	$ 6,331

Amortization of $347,000 (2018 – $334,000) has been recognized in cost of sales, $137,000 (2018 – $137,000) has been recognized in selling and distribution, $549,000 (2018 – $561,000) has been recognized in general and administrative and $64,000 (2018 – $329,000) has been recorded within discontinued operations.

In 2018, as a result of the closure of the Italian operations, an impairment charge of $2,388,000 related to the technology intangible assets and $575,000 related to the customer relationships intangible assets has been recorded and included in discontinued operations, see note 24.

None of the intangible assets has been internally developed.

Research and development expenses of $785,000 (2018 – $1,117,000) have been recognized in cost of sales in the consolidated statements of earnings. No research and development costs have been capitalized (2018 – $nil).

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Goodwill	December 31, 2019	December 31, 2018
Opening balance	$ 11,961	$ 17,022
Impairment (note 12)	–	(5,054)
Effect of movements of exchange rates	(652)	(7)
Ending balance	$ 11,309	$ 11,961

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 2019 annual impairment assessment, the Company did not identify any triggering events during the course of 2019 indicating that the carrying amount of its assets and CGU's may not be recoverable.

Impairment testing for cash-generating units containing goodwill

The Company has two subsidiaries identified as cash generating units that contain goodwill. The cash generating units ("CGUs") and their respective goodwill balances are as follows: Delta Transformers Inc. $2,180,000 (2018 – $2,180,000), Hammond Power Solutions Private Limited $9,129,000 (2018 – $9,781,000). In the past the Company also had an Italian cash generating unit which contained goodwill, however, in 2018, given the closure of the Italian operations, all goodwill related to this CGU was written off.

For its 2019 annual impairment assessment of CGUs 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.

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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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 12.5% – 20.8% (2018 –11.9% – 18.7%) depending on the location of the entity. Through the five year cash flow projections, the Company's model also incorporated annual sales growth rates in the range of 1.4% – 52.6% (2018 – 5.0% – 30.1%) depending on location, the CGUs operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using steady growth rates ranging from 2% – 8% (2018 – 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.

Upon completion of the 2019 annual impairment assessment of goodwill it was determined that the recoverable amount of the CGUs exceeded their respective carrying values and no impairment existed at December 31, 2019.

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.

Management believes that any reasonable possible change in the key assumptions on which the recoverable amounts are based could cause the carrying amount to exceed the recoverable amount in the Hammond Power Solutions Private Limited CGU. As of December 31, 2019, a discount rate increase of 0.5% or a 2.0% lower sales growth rate than forecast would cause the estimated recoverable amount to be equal to the carrying amount for this CGU.

For its Delta Transformers Inc. CGU, management believes that any reasonable possible change in the key assumptions on which the recoverable amounts are based would not could cause the carrying amount to exceed the recoverable amount.

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 revolving credit facility can be drawn in of U.S. Prime borrowings, Canadian Prime borrowings, CDOR borrowings or LIBOR borrowings. 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, 2019 and December 31, 2018. 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 2020 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 December 31, 2019 – 0.249%, Euribor on December 31, 2018 – 0.373%).

Hammond Power Solutions Private Limited maintains an additional demand credit facility for an unsecured working capital loan up to 375,000,000 INR (2018 – 375,000,000 INR) consisting of the sub-facilities of an 131,000,000 INR (2018 – 174,000,000 INR) short-term working capital demand loan, a 244,000,000 INR (2018 –

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

201,000,000 INR) facility for bank guarantees and did not have any letters of credit at December 31, 2019 (2018 – $nil) 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, 2019, there was $nil Canadian dollar equivalent of Rupees drawn against the working capital demand loan (2018 – $1,146,000). At December 31, 2019 there was nil INR (2018 – 164,000,000 INR) drawings against the bank guarantees. There was no drawings against the bill discounting facility.

Based on exchange rates in effect at December 31, 2019, the combined Canadian dollar equivalent available across all facilities, prior to any utilization of the facilities was $77,737,000 (2018 – $81,862,000).

As at December 31, 2019, the Canadian dollar equivalent outstanding under the U.S. dollar revolving credit line was $28,145,000, consisting of $17,546,000 Canadian dollars drawn and $8,160,000 U.S. dollars drawn (approximately $10,599,000 Canadian dollars) (2018 – $26,568,000 – consisting of $15,500,000 Canadian dollars drawn and $8,092,000 U.S. dollars drawn (approximately $11,035,000 Canadian dollars)). As well, $4,552,000 (2018 – $4,887,000) Canadian dollar equivalent of Euros was outstanding under the Euro facility, and $nil (2018 – $1,146,000) 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. Lease assets and liabilities

Lease assets

The Group leases many assets including buildings, vehicles and office equipment. Information about leases for which the Group is a lessee is presented below.

		Buildings		Vehicles		Office Equipment		Total
Balance at January 1, 2019	$	8,539	$	470	$	49	$	9,058
Additions		1,471		366		–		1,837
Depreciation		(1,529)		(315)		(23)		(1,867)
Effect of movements in exchange rates		22		2		1		25
Balance at December 31, 2019	$	8,503	$	523	$	27	$	9,053

Certain of the building leases maintained by the Group contain renewal options. Where practicable, the Group seeks to include extension options in new leases to provide operational flexibility. The majority of the Group's lease payments relate to its production facilities in Mexico. The first renewal option commences in May 2020, with annual lease payments of $621,000, and is for a five year term. The Group retains rights to renew this lease for 3 successive 5-year periods. The Group's lease on its second Mexican production facility expires in March 2023 and carries annual lease payments of $581,000. The Group holds a right to renew this lease for one 4 year period following the expiry of the current lease term. The extension options held are exercisable only by the Group and not by the lessors. The Group assesses at lease commencement whether it is reasonably certain to exercise the options.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Lease liabilities

Maturity analysis – contractual undiscounted cash flows	**December 31, 2019**
Less than one year	$ 2,602
One to five years	9,318
More than five years	696
Total undiscounted lease liabilities	$ 12,616
Less: effect of discounting	$ (1,212)
Lease liabilities included in the statement of financial position	$ 11,404
Current	$ 2,237
Non-current	$ 9,167

Amounts recognized in statement of operations	**Year Ended December 31, 2019**
Interest on lease liabilities	$ 325

Amounts recognized in statement of cash flows	**Year Ended December 31, 2019**
Payment of lease liabilities	$ 2,431

A reconciliation of the Group’s previously disclosed operating commitments and its lease obligations recognized on transition to IFRS 16 is as follows:

	January 1, 2019
Operating leases and other commitments as at December 31, 2018	$ 3,301
Less: Commitments cancelled due to discontinued operations	(438)
Add: Extension options included in calculations	10,072
Less: Effect of discounting using the incremental borrowing rate	(1,278)
Operating leases qualifying as right-of-use liabilities as at January 1, 2019	$11,657

15. Commitments

	December 31, 2019	December 31, 2018
Capital expenditure commitments	$ 80	$ 92

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

16. Income taxes

Income tax expense		**2019**		2018
Current tax expense				
Current period	$	6,425	$	4,768
Deferred tax expense (recovery)				
Origination and reversal of temporary differences		(579)		(1,371)
Decrease in tax rate		36		–
		(543)		(1,371)
Total income tax expense	$	5,882	$	3,397

Reconciliation of effective tax rate

	2019		**2019**	**2018**		**2018**
Net earnings (loss)		$	11,607		$	(12,917)
Income tax expense			5,882			3,397
Earnings (loss) before income taxes		$	17,489		$	(9,520)
Income tax (recovery) using the Company's domestic tax rate	39.50%		6,908	39.50%		(3,760)
Effect of tax rates in foreign jurisdictions	(10.36%)		(1,811)	(17.47%)		1,663
Decrease in tax rate	0.20%		36	–		–
Non-deductible expenses/non-taxable income	2.23%		390	(43.47%)		4,138
Reduced rate for active business and manufacturing and processing	(4.25%)		(744)	0.14%		(13)
Losses for which no deferred tax asset was recognized	3.56%		623	(67.31%)		6,408
Basis difference in subsidiary	–		–	52.33%		(4,982)
Dividend withholding tax	3.72%		650	–		–
Other	(0.97%)		(170)	0.60%		(57)
	33.63%	$	5,882	(35.68%)	$	3,397

Unrecognized temporary differences

At December 31, 2019, pre-tax temporary differences of $96,643,000 (2018 – $106,693,000) 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. The tax liability in the event the Company were to sell these investments would be $12,080,000 (2018 – $13,337,000) based on current tax rates.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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

	2019	2018
Tax losses	$ 12,458	$ 13,643
Basis difference in subsidiary	37,356	36,527
Financial interests deductible in a future period	2,875	1,694
Bad debt provisions	900	–
Inventory provisions	361	–
	$ 53,950	$ 51,864

The tax losses, financial interests deductible, bad debt provision and inventory provisions carry forward indefinitely and relate to HPS S.p.A and Continental Transformers s.r.l. The basis difference in subsidiary, when realized, will provide the Company a capital loss that carries forward indefinitely. The benefit of these items has not been reflected in the consolidated financial statements as it is uncertain as to whether the Company will be able to utilize the deductions.

Recognized deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities	
	2019	2018	2019	2018
Property, plant and equipment	$ 766	$ 785	$ (4,763)	$ (2,796)
Intangible assets	–	13	(767)	(895)
Scientific research and experimental development	9	9	(46)	(68)
Inventories	228	234	–	–
Long-term lease and note receivable	–	–	(2,974)	(3,245)
Loans and borrowings	3,123	–	–	–
Employee benefits	233	159	(153)	(145)
Unrealized losses (gains) on forward contracts and foreign-currency denominated loans payable/receivable	728	752	–	–
Provisions and tax reserves	1,465	1,782	(2)	(3)
Tax loss carry-forwards	1,151	858	–	–
Charitable donation carry-forwards	–	3	–	–
Basis difference in subsidiary	1,127	1,467	–	–
Tax assets (liabilities)	8,830	6,062	(8,705)	(7,152)
Set off of tax	(6,886)	(5,020)	6,886	5,020
Net tax assets (liabilities)	$ 1,944	$ 1,042	$ (1,819)	$ (2,132)

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Movement in temporary differences during the year ended December 31, 2019

	Balance December 31, 2018	Recognized in retained earnings	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2019
Property, plant and equipment	$ 2,011	$ 1,686	$ 300	$ –	$ 3,997
Intangible assets	882	–	(115)	–	767
Scientific research and experimental development	59	–	(22)	–	37
Inventories	(234)	–	6	–	(228)
Long-term lease and note receivable	3,245	–	(271)	–	2,974
Loans and borrowings	–	(2,325)	(798)	–	(3,123)
Employee benefits	(14)	–	(66)	–	(80)
Unrealized gains on forward contracts and foreign-denominated loans payable/receivable	(752)	–	24	–	(728)
Provisions and tax reserves	(1,779)	–	316	–	(1,463)
Tax loss carry-forwards	(858)	–	(293)	–	(1,151)
Basis difference in subsidiary	(1,467)	–	340	–	(1,127)
Charitable donation carry-forwards	(3)	–	3	–	–
	$ 1,090	$ (639)	$ (576)	$ –	$ (125)
Foreign exchange			$ 33		
Income tax expense			$ (543)		

Movement in temporary differences during the year ended December 31, 2018:

	Balance December 31, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2018
Property, plant and equipment	$ 2,442	$ (431)	$ –	$ 2,011
Intangible assets	1,917	(1,035)	–	882
Scientific research and experimental development	46	13	–	59
Inventories	(311)	77	–	(234)
Long-term lease and note receivable	1,090	2,155	–	3,245
Loans and borrowing	–	–	–	–
Employee benefits	58	(72)	–	(14)
Unrealized gains on forward contracts and foreign-denominated loans payable/receivable	(212)	(540)	–	(752)
Provisions and tax reserves	(1,514)	(265)	–	(1,779)
Tax loss carry-forwards	(950)	92	–	(858)
Basis difference in subsidiary	–	(1,467)	–	(1,467)
Charitable donation carry-forwards	–	(3)	–	(3)
	$ 2,566	(1,476)	$ –	$ 1,090
Foreign exchange		$ 105		
Income tax expense		$ (1,371)		

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

17. 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, 2019		December 31, 2018	
8,966,624	Class A subordinate voting shares (2018 – 8,962,424)	$	14,484	$	14,210
2,778,300	Class B common shares (2018 – 2,778,300)		7		7
11,744,924	Total A and B shares (2018 – 11,740,724)	$	14,491	$	14,217

During the year ended December 31, 2019, 45,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $290,000 and a transfer of $49,000 from contributed surplus. During the year ended December 31, 2018, 30,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $207,000 and a transfer of $38,000 from contributed surplus.

During 2019, the company purchased and cancelled 40,800 Class A shares under a normal course issuer bid at a cost of $316,000 of which $65,000, $12,000, $239,000 was applied against share capital, contributed surplus and retained earnings respectively. During 2018, the company purchased and cancelled 9,200 Class A shares under a normal course issuer bid at a cost of $53,000 of which $14,000, $3,000, $36,000 was applied against share capital, contributed surplus and retained earnings respectively. The normal course issuer bid was approved by the Board of Directors on November 9, 2018 and authorized the repurchase of up to 50,000 Class A shares. The normal course issuer bid was completed in Quarter 3, 2019.

The following dividends were declared and paid by the Company:

	December 31, 2019		December 31, 2018	
28 cents per Class A subordinate voting shares (2018 – 24 cents)	$	2,509	$	2,151
28 cents per Class B common shares (2018 – 24 cents)		778		667
	$	3,287	$	2,818

(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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

There were no options granted for the year ended December 31, 2019, or the year ended December 31, 2018.

Options outstanding and exercisable as at December 31, 2019:

	December 31, 2019			December 31, 2018		
	Number of options		Weighted average exercise price	Number of options		Weighted average exercise price
Outstanding, beginning of year	509,000	$	8.32	694,000	$	9.01
Exercised	(45,000)		6.43	(30,000)		6.92
Cancelled	(15,000)		9.17	–		–
Expired	(119,000)		9.74	(155,000)		11.70
Outstanding, end of year	330,000	$	7.99	509,000	$	8.32

		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
$	10.00	125,000	0.2		10.00	125,000		10.00
	7.50	70,000	1.2		7.50	70,000		7.50
	6.62	55,000	2,2		6.62	55,000		6.62
	6.20	80,000	3.2		6.20	80,000		6.20
		330,000	1.5	$	7.99	330,000	$	7.99

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 14, 2013	125,000	Board of Directors, Officers and Senior Management
March 13, 2014	70,000	Board of Directors, Officers and Senior Management
March 12, 2015	55,000	Board of Directors and Officers
March 10, 2016	80,000	Board of Directors and Officers
Total stock options outstanding	330,000	

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

(d) Deferred Share Units

Under the DSU Plan, participants may elect to defer compensation and receive DSUs equal to the value of the deferred compensation. The first DSUs were issued in March 2017. The number of DSUs was determined by dividing the amount of deferred compensation by the Fair Market Value of DSUs, 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 DSUs held by that participant and the Fair Market Value on the date of the Redemption Event. The DSUs do not contain any vesting conditions or forfeiture provisions, as they are issued in exchange for deferred compensation, nor are they performance based. Under the DSU Plan, outstanding DSUs as at the record date are increased by the dividend rate whenever dividends are paid to shareholders.

The movement in DSUs for the year ended December 31, 2019 is as follows:

	Number of DSUs	Closing Share Price	
Balance at January 1, 2019	69,151	$	5.70
DSUs Issued	61,447		–
DSUs redeemed	(9,027)		7.65
Balance at December 31, 2019	121,571	$	7.68

An expense of $367,000 (2018 – $109,000) was recorded in general and administrative expenses. The liability of $934,000 (2018 – $394,000) related to these DSUs is included in accounts payable and accrued liabilities.

18. Earnings per share

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

		2019		2018 (recast – note 2(a))
Basic earnings per share from continuing operations	$	1.13	$	0.62
Calculated as:				
Net Earnings attributable to the equity holders of the Company from continuing operations	$	13,306	$	7,256
Weighted average number of shares outstanding		11,735,495		11,742,624
Fully diluted earnings per share from continuing operations	$	1.13	$	0.62
Calculated as:				
Net Earnings attributable to the equity holders of the Company from continuing operations	$	13,306	$	7,256
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares		11,755,662		11,783,650
Reconciliation of weighted average number of shares outstanding:				
Weighted average number of shares outstanding used to calculate basic earnings per share		11,735,495		11,742,624
Adjustment for dilutive effect of stock option plan		20,167		41,026
Weighted average number of shares outstanding used to calculate diluted earnings per share		11,755,662		11,783,650

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

As at December 31, 2019, 195,000 options (2018 – 259,000) are excluded from the diluted average number of shares calculation as their effect would have been anti-dilutive.

The computations for basic and diluted loss per share from discontinued operations are as follows:

		2019		2018 (recast – note 2(a))
Basic loss per share from discontinued operations	$	(0.14)	$	(1.72)
Calculated as:				
Net loss attributable to the equity holders of the Company from discontinued operations	$	(1,699)	$	(20,173)
Weighted average number of shares outstanding		11,735,495		11,742,624
Fully diluted loss per share from discontinued operations	$	(0.14)	$	(1.72)
Calculated as:				
Net loss attributable to the equity holders of the Company from discontinued operations	$	(1,699)	$	(20,173)
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares		11,735,495		11,742,624
Reconciliation of weighted average number of shares outstanding:				
Weighted average number of shares outstanding used to calculate basic earnings per share		11,735,495		11,742,624
Adjustment for dilutive effect of stock option plan		–		–
Weighted average number of shares outstanding used to calculate diluted earnings per share		11,735,495		11,742,624

		2019		2018
Basic earnings (loss) per share	$	0.99	$	(1.10)
Calculated as:				
Net Earnings attributable to the equity holders of the Company	$	11,607	$	(12,917)
Weighted average number of shares outstanding		11,755,662		11,742,624
Fully diluted earnings per share	$	0.99	$	(1.10)
Calculated as:				
Net Earnings attributable to the equity holders of the Company	$	11,607	$	(12,917)
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares		11,755,662		11,742,624
Reconciliation of weighted average number of shares outstanding:				
Weighted average number of shares outstanding used to calculate basic earnings per share		11,735,495		11,742,624
Adjustment for dilutive effect of stock option plan		20,167		–
Weighted average number of shares outstanding used to calculate diluted earnings per share		11,755,662		11,742,624

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

19. Non-controlling interest

Purchase of non-controlling 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%.

20. Pension plans

Defined contribution plan:

The Group has defined contribution pension plans that are available to virtually all of its Canadian employees with eligible employee contributions based on 2.00% – 6.75% of annual earnings. The Group's contributions of $1,586,000 (2018 – $1,457,000) matches the employee contributions. The Group's contributions related to its defined contribution pension plans are recorded as follows: $1,190,000 (2018 – $1,084,000) in cost of sales, $197,000 (2018 – $183,000) in selling and distribution, and $199,000 (2018 – $190,000) in general and administrative.

21. Provisions

	Warranties	Site restoration	Benefits	Restructuring	Total
Balance at January 1, 2018	$ 379	$ 178	$ 222	$ –	$ 779
Provisions made during the period	622	104	220	6,792	7,738
Provisions used during the period	(420)	(104)	(146)	(560)	(1,230)
Balance at December 31, 2018	$ 581	$ 178	$ 296	$ 6,232	$ 7,287
Balance at January 1, 2019	$ 581	$ 178	$ 296	$ 6,232	$ 7,287
Provisions made during the period	807	130	19	947	1,903
Provisions used during the period	(768)	(109)	(86)	(4,197)	(5,160)
Recovery of provisions (note 23)	–	–	–	(2,035)	(2,035)
Balance at December 31, 2019	$ 620	$ 199	$ 229	$ 947	$ 1,995
Current portion	$ 620	$ 99	$ 44	$ 947	$ 1,710
Non-current portion	$ –	$ 100	$ 185	$ –	$ 285

Warranties

The provision for warranties relates mainly to transformers sold during the years ended December 31, 2019 and December 31, 2018. 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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Benefits

The benefit provision relates to statutory pension and leave benefits related to the India facility. Substantially all of this benefit is long-term.

Restructuring charges

The restructuring charges relate to estimated severance, termination benefits and closure costs in respect of the closure of the Italian operations. Such costs are anticipated to be settled within the following year. See note 24 for details.

22. Sales

	2019	2018
Canada	$ 116,996	$ 93,641
United States and Mexico	225,709	197,860
India	16,077	22,581
	358,782	314,082
Italy – discontinued operations	281	7,720
	$ 359,063	$ 321,802

As at December 31, 2019 the Company had contract liabilities of $268,000 (2018 – $280,000) included in accounts payable and accrued liabilities.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

23. Discontinued operations

In December 2018, the Company closed our Italian operations due to low sales volume and a weak economy. Prior to this, the Italian operation was not previously classified as a discontinued operation. The consolidated statements of operations have been presented for the years ended December 31, 2019 and December 31, 2018 to show the discontinued operation separately from continuing operations.

	2019	2018
Revenue	$ 281	$ 7,720
Cost of sales	1,461	7,965
Gross loss	(1,180)	(245)
Selling and distribution	225	1,038
General and administrative	335	2,445
Impairment of goodwill, intangibles and plant and equipment (note 24)	–	9,693
Restructuring charges (recovery) (note 24)	(728)	6,792
Loss from operations	(1,012)	(20,213)
Interest income	–	40
Loss on disposition of assets	(687)	–
Loss from discontinued operations before tax	(1,699)	(20,173)
Income tax	–	–
Loss from discontinued operations, net of tax	$ (1,669)	$ (20,173)

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

In November 2019, the Group entered into an agreement to sell the inventory and certain equipment of the Italian operation, and for the purchaser to assume certain of the employee obligations and lease the manufacturing facility from the Group. Cash consideration paid to the Group in connection with the transaction was 1,086,000 EUR (approximately $1,583,000 Canadian dollars). The transaction resulted in a loss on disposition in the amount of $687,000, calculated as follows:

		Candian dollar values
Total consideration	$	1,583
Property, plant and equipment	$	1,539
Inventory		885
Employee liabilities		(154)
Carrying value of net assets sold	$	2,270
Loss on disposition	$	687

Cash flows from discontinued operations

Cash flows from discontinued operations, are included within the following components of the Statements of Cash Flows:

		2019		2018
Net cash used in operating activities	$	(643)	$	1,485
Net cash generated by investing activities		1,460		(401)
Net cash used in financing activities		–		40

24. Restructuring charges

2019 activity

During 2019 additional information regarding restructuring costs was identified related to the closure of the Italian operations, as outlined below. The following table highlights the amounts charged to expense for the twelve month period ending December 31, 2019:

		Restructuring Charges
Cancellation and closure costs	$	947
Expected credit loss – VAT Receivable		360
	$	1,307

The amount of the cancellation and closure costs have been included in provisions in the amount of $947,000. As of December 31, 2019, $nil of these costs had been paid.

In connection with the hiring of certain of the employees of the Italian operation by the purchaser, $2,035,000 of previously recorded severance and terminations provisions were reversed, by virtue of the purchaser assuming this obligation. The remaining $4,197,000 of severance and termination benefits provided for at December 31, 2018 were paid during 2019.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

2018 activity

For the year ended December 31, 2018, the Company decided to close the Italian operation as the entity struggled to generate adequate sales and profits. The restructuring charges were comprised of severance and benefit costs related to workforce reductions, closure and cancellation costs and impairments of goodwill and intangible assets, totaling $16,485. The restructuring activities were undertaken to adjust the Company's cost structure and streamline various support activities in consideration of the current and expected industry market conditions. These charges are reported in the discontinued operations within the consolidated statements of operations.

The following table highlights the amounts charged to expense for the twelve month period ending December 31, 2018:

		Restructuring Charges
Employee termination benefits	$	5,116
Cancellation and closure costs		1,676
		6,792
Write down of inventory		609
Write down of property, plant and equipment		1,067
Impairment of goodwill		5,054
Impairment of intangible assets		2,963
	$	16,485

As of December 31, 2018, $560,000 of the employee termination benefits had been paid. The remainder of the employee termination benefits and the cancellation and closure costs have been included in provisions in the amount of $6,808,000.

25. Related party transactions

Related parties

Arathorn Investments Inc. beneficially owns 2,778,300 (2018 – 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 1,063,152 (2018 – 1,060,624) Class A subordinate voting shares of the Company, representing approximately 11.9% (2018 – 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 $1,075,000 (2018 – $921,000).

Transactions with key management personnel

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.

During the year, the Group purchased $300,000 (2018 – $322,000) 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 $32,000 (2018 – $39,000) which is owed to this company.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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:

		2019		2018
Salaries and benefits	$	2,308	$	2,758
Share-based awards		367		318
	$	2,675	$	3,076

26. Personnel expenses

		2019		2018
Wages and salaries	$	58,972	$	53,969
Group portion of government pension and employment pension and employment benefits		16,314		15,031
Contributions to defined contribution plans		1,586		1,457
	$	76,872	$	70,457

27. Change in operating working capital

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

		2019		2018
Accounts receivable	$	5,006	$	(9,840)
Inventories		(2,290)		(10,906)
Prepaid expenses and other assets		(384)		196
Accounts payable and accrued liabilities		119		8,896
Provisions		(5,160)		–
Foreign exchange		(3,665)		6,102
	$	(6,374)	$	(5,552)

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

28. 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		2019		2018
Sales				
Canada	$	116,996	$	93,641
United States and Mexico		225,709		197,860
India		16,077		22,581
		358,782		314,082
Italy – discontinued operations		281		7,720
	$	359,063	$	321,802
Property, plant and equipment and right-of-use assets – net				
Canada	$	17,667	$	17,964
United States		6,769		2,852
Mexico		5,183		377
Italy		95		5,285
India		2,754		2,560
	$	32,468	$	29,038
Investment in properties				
Canada	$	1,044	$	1,044
Italy		2,665		–
	$	3,709	$	1,044
Investment in joint venture				
Mexico	$	13,428	$	13,302
Intangibles, net				
Canada	$	3,641	$	4,065
Italy		17		86
India		2,673		3,159
	$	6,331	$	7,310
Goodwill				
Canada	$	2,180	$	2,180
India		9,129		9,781
	$	11,309	$	11,961

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

29. 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 net liability of $1,392,000 (2018 – net asset of $1,605,000) 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 between levels in 2019 or 2018.

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 receivable is valued at the present value of the future receipts and has a fair value of $nil due to collection concerns. The lease receivable is valued at the present value of the future receipts which approximates the fair value.

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 Indian Rupee as compared to the Canadian dollar. At December 31, 2019, the Company had outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2020.

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	9,2000,000	1.4562
BUY	EUR	USD	8,000,000	1.1212
BUY	USD	CAD	104,000,000	1.2990 – 1.3306
BUY	USD	INR	9,198,165	71.4200 – 72.0900
BUY	USD	MXN	12,357,454	18.9440
Buy/Sell	**Sell Currency**	**Buying Currency**	**Amount of Sell Currency**	**Traded Rate**
SELL	USD	MXN	24,000,000	18.9898 – 19.5083
SELL	EUR	CAD	18,400,000	1.4574 – 1.4682
SELL	EUR	USD	16,000,000	1.1041 – 1.1222
SELL	USD	CAD	52,000,000	1.2985
SELL	USD	INR	4,634,831	71.2000

At December 31, 2018, the Company has outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2019.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	8,300,000.00	1.5642
BUY	EUR	USD	7,900,000.00	1.1460
BUY	USD	CAD	90,000,000.00	1.3256 – 1.3645
BUY	USD	INR	3,689,028	69,9700 – 70,9960
BUY	USD	MXN	11,452,237.20	19.6607
Buy/Sell	**Buy Currency**	**Selling Currency**	**Amount of Buy Currency**	**Traded Rate**
SELL	USD	MXN	22,000,000.00	19.7201 – 20.4690
SELL	EUR	CAD	16,600,000.00	1.4996 – 1.5654
SELL	EUR	USD	15,800,000.00	1.1342 – 1.1471
SELL	USD	CAD	45,000,000.00	1.3646
SELL	USD	INR	1,863,265.01	69.7700

As at December 31, 2019 the Group has recognized a net unrealized loss of $1,392,000 representing the fair value of these forward foreign exchange contracts, comprised of an obligation recognized within accounts payable and accrued liabilities. As at December 31, 2018 the Group recognized a net unrealized gain of $1,605,000, comprised of an asset of $1,793,000 included with prepaid expenses and other assets, and a liability of $188,000 included within accounts payable and accrued liabilities.

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) credit 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.There were no changes to types of risk arising from the Group's financial instruments from the previous period.

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.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

The following table represents the Group's balance sheet exposure to currency risk as at December 31, 2019:

	U.S. Dollars		Mexican Pesos		Euros		Indian Rupees	
		2018		2018		2018		2018
Cash	$ 10,639	$ 8,566	3,680	482	€ 1,717	€ 942	71,670	1,148
Accounts receivable	28,575	26,400	26,387	20,401	1,238	1,486	289,551	522,059
Long-term lease receivable	–	–	–	–	2,332	2,454	–	–
Bank operating lines of credit	8,160	8,024	–	–	3,144	3,146	–	58,751
Accounts payable	19,507	17,568	10,376	8,138	359	1,292	93,427	282,830
Lease obligation	8,170	–	–	–	–	–	9,295	–
Net exposure	$ 3,377	$ 9,374	19,691	12,745	€ 1,784	€ 444	258,499	181,626

A one cent ($0.01) decline in the Canadian dollar against the U.S dollar as at December 31, 2019 would have increased net earnings by $11,000 and increased equity by $264,000. This analysis assumes that all other variables, in particular interest rates, remained constant. Inversely, a one cent ($0.01) increase in the Canadian dollar against the U.S. dollar as at December 31, 2019 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, 2019 would have decreased net earnings by $46,000 and increased equity by $27,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Euro as at December 31, 2019 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Indian Rupee as at December 31, 2019 would have increased net earnings and equity by $49,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Indian Rupee as at December 31, 2019 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, 2019 would have decreased net earnings by $3,000 and increased equity by $14,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Peso as at December 31, 2019 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, 2019, 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.

The Group's exposure to customer credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the factors that may influence the credit risk of its customer base, including the default risk associated with the industry and country in which customers operate.

Management has a credit policy under which each new customer is analysed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group's review includes external ratings, if they are available, financial statements, credit agency information, industry information and in some cases bank references. Sale limits are established for each customer and reviewed quarterly. Any sales exceeding those limits require approval from Executive management.

The Group limits its exposure to credit risk from trade receivables by establishing a reasonable payment period. Many of the Group's customers have been transacting with the Group for a number of years, and none of these customers' balances have been written off or are credit-impaired at the reporting date.

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

In monitoring customer credit risk, customers are grouped according to their credit characteristics, including their geographic location, industry, trading history with the Group and existence of previous financial difficulties.

An allowance account for accounts receivable is used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible; at which point the amounts are considered to be uncollectible and are written off against the specific accounts receivable amount attributable to a customer. The number of days outstanding of an individual receivable balance is the key indicator for determining whether an account is at risk of being impaired.

Expected credit losses are required to be measured through a loss allowance at an amount equal to the 12-month expected credit losses or full lifetime expected credit losses. The Group has used past due information to determine that there have been no significant increases in credit risk since initial recognition. There are balances in excess of 30 days past due but the Group does not presume that credit risk has increased given the characteristics of the Group's customers, the industries in which they operate, the customer payment track records and the nature of the products the Group sells.

During the year, the expected credit losses for trade accounts receivables increased $516,000 (2018 – $520,000), 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, 2019		December 31, 2018	
	Gross	Allowance	Gross	Allowance
Not past due	$ 43,287	$ –	$ 37,090	$ –
Past due 0-30 days	11,251	–	18,743	–
Past due 31-120 days	6,991	–	10,853	–
Past due more than 120 days	5,472	2,997	4,805	2,481
	$ 67,001	$ 2,997	$ 71,491	$ 2,481

Credit risk

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

	Carrying Amount	
	December 31, 2019	December 31, 2018
Cash and cash equivalents	$ 23,371	$ 15,545
Accounts receivable	64,004	69,010
Derivative asset	–	1,793
Lease receivable	3,397	3,837
	$ 90,772	$ 90,185

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

	Carrying Amount	
	December 31, 2019	December 31, 2018
Canada	$ 17,435	$ 18,421
United States	36,987	36,094
Mexico	1,818	1,335
Italy	827	2,450
India	6,937	10,710
	$ 64,004	$ 64,010

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

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 that bear interest at floating interest rates.

The Group manages its interest rate risk by minimizing the bank operating lines of credit balances by applying 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, 2019 would increase or decrease net earnings by approximately $327,000 (2018 – $326,000) 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 supply contracts with certain suppliers, and from time to time will enter into forward commodity purchase contracts. As at December 31, 2019, no forward commodity purchase contracts were outstanding (2018 – 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, 2019	Carrying amount	1 year or less	1-2 years	2-5 years
Bank operating lines of credit	$ 32,697	$ –	$ 32,697	–
Accounts payable and accrued liabilities	54,824	54,824	–	–
Derivative liabilities	1,392	1,392	–	–
	$ 88,913	$ 56,216	$ 32,697	$ –

December 31, 2018	Carrying amount	1 year or less	1-2 years	2-5 years
Bank operating lines of credit	$ 32,601	$ –	$ –	$ 32,601
Accounts payable and accrued liabilities	54,138	54,138	–	–
Derivative liabilities	188	188	–	–
	$ 86,927	$ 54,326	$ –	$ 32,601

For the years ended December 31, 2019 and 2018 (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 activites:

	Liabilities		Equity		
	Bank Operating Lines of Credit	Lease Liabilities	Share Capital	Retained Earnings	Total
Balance January 1, 2019	$ 32,601	$ 11,657	$ 14,217	$ 79,218	$ 137,693
Implementation of accounting standard	–	–	–	(1,960)	(1,960)
Adjusted balance January 1, 2019	$ 32,601	$ 11,657	$ 14,217	$ 77,258	$ 135,733
Advances of bank operating lines of credit	96	–	–	–	96
Interest payments	(1,420)	(325)	–	–	(1,745)
Proceeds from issue of share capital	–	–	290	–	290
Share repurchase	–	–	(77)	(239)	(316)
Cash dividends paid	–		–	(3,287)	(3,287)
Repayment of lease liability	–	(2,431)	–	–	(2,431)
Total changes from financing cash flows	$ (1,324)	$ (2,756)	$ 213	$ (3,526)	$ (7,393)
Other changes					
Liability-related					
Interest expense	1,420	–	–	–	1,420
Non-cash additions to lease liabilities	–	1,853	–	–	1,853
Total liability-related other changes	$ 1,420	$ 1,853	$ –	$ –	$ 3,273
Equity-related					
Share repurchase	–	–	12	–	12
Exercise of stock options	–	–	49	–	49
Net income	–	–	–	11,607	11,607
Total equity-related other changes	$ –		$ 61	$ 11,607	$ 11,668
Balance December 31, 2019	$ 32,697	$ 10,754	$ 14,491	$ 85,339	$ 143,281

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

	Liabilities	**Equity**		
	Bank Operating Lines of Credit	Share Capital	Retained Earnings	Total
Balance January 1, 2018	$ 27,755	$ 13,986	$ 96,346	$ 138,087
Advances of bank operating lines of credit	4,846	–	–	4,846
Interest payments	(1,423)	–	–	(1,423)
Proceeds from issue of share capital	–	207		207
Share repurchase	–	(17)	(36)	(53)
Cash dividends paid	–	–	(2,818)	(2,818)
Total changes from financing cash flows	$ 3,423	$ 190	$ (2,854)	$ 759
Other changes				
Liability-related				
Interest expense	1,423	–	–	1,423
Total liability-related other changes	$ 1,423	$ –	$ –	$ 1,423
Equity-related				
Purchase of non-controlling interest	–	–	(1,357)	(1,357)
Share repurchase	–	3	–	3
Exercise of stock options	–	38	–	38
Net loss	–	–	(12,917)	(12,917)
Total equity-related other changes	$ –	$ 41	$ (14,274)	$ (14,233)
Balance December 31, 2018	$ 32,601	$ 14,217	$ 79,218	$ 126,036

30. 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, 2019.

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

	December 31, 2019	December 31, 2018
Cash and cash equivalents	$ 23,371	$ 15,545
Bank operating lines of credit	(32,697)	(32,601)
Share capital	14,491	14,217
Contributed surplus	2,498	2,559
Retained earnings	85,339	79,218
	$ 93,002	$ 78,938

For the years ended December 31, 2019 and 2018 (tabular amounts in thousands of dollars, except share and per share amounts)

31. 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 lease receivable 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 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 and is considered to be valued at Level 2 of the fair value hierarchy.

31. Subsequent events

Dividends

On March 6, 2020, the Company declared a quarterly cash dividend of eight and a half cents ($0.085) per Class A subordinate voting shares of HPS and a quarterly cash dividend of eight and a half cents ($0.085) per Class B common shares of HPS payable on March 26, 2020 to shareholders of record at the close of business on March 19, 2020. The ex-dividend date is March 18, 2020.

COVID-19

On March 11, 2020, the World Health Organization declared the global outbreak of the Coronavirus, COVID-19, a pandemic. The extent of the impact COVID-19 will have on the operations and financial results of the Company in fiscal 2020 is currently not known with certainty.

HPS Offices, Manufacturing Facilities and Warehouse Locations

Canada
Hammond Power Solutions Inc.

Corporate Head Office
595 Southgate Drive
Guelph, Ontario N1G 3W6

15 Industrial Road
Walkerton, Ontario N0G 2V0

10 Tawse Place
Guelph, Ontario N1H 6H9

Delta Transformers Inc.

795 Industriel Boul.
Granby, Quebec J2G 9A1

3850 place de Java
Suite 200
Brossard, Québec J4Y 0C4

India
Hammond Power Solutions Private Limited

2nd Floor
Icon Plaza, H. No. 5-2/222/IP/B
Allwyn X-Roads
Miyapur, Hyderabad – 500049

Italy
Hammond Power Solutions S.p.A.

Via Amedeo Avogadro 26
10121 Torino, Italy
at R & P Legal

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

Ave. Avante #810
Parque Industrial Guadalupe
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
Guadalupe, Nuevo León, México
C.P. 67190

United States
Hammond Power Solutions, Inc.

1100 Lake Street
Baraboo, Wisconsin 53913

17715 Susana Road
Compton, California 90224

6550 Longley Lane, Suite 135
Reno, Nevada 89511

Annual General Meeting

Shareholders are cordially invited to attend the Annual General Meeting held:
Thursday, May 14, 2020
1:30 p.m. (EST)

Cutton Fields
190 College Avenue East,
Guelph, Ontario N9H 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

Cassels, Brock and Blackwell LLP
40 King Street West, Suite 2100,
Toronto, Ontario M5H 3C2

Banking Institution

JP Morgan Chase
Bank N.A. 66 Wellington Street West,
Suite 4500
Toronto, Ontario 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

GO AS FAR AS YOU CAN SEE;
WHEN YOU GET THERE,
YOU'LL BE ABLE TO SEE FURTHER.

Hammond Power Solutions Inc.

HAMMONDPOWERSOLUTIONS.COM