

A young boy and girl are standing in a field of tall grass, holding hands and looking up at the sky. The boy is on the left, wearing a dark t-shirt and jeans. The girl is on the right, wearing a striped shirt and jeans. The background is a clear, light sky.

# Q3

For the nine months ended  
September 27, 2014



Hammond Power  
Solutions Inc.

# Our Vision

To be the leader in our industry by delivering:

- ❖ Lead times as defined by our customers
- ❖ A broad range of competitive products
- ❖ Quality and service excellence in all that we do
- ❖ Technical expertise
- ❖ Strong financial performance

# Our Mission

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

# Our Values

- ❖ We value **honesty, integrity** and **ethical behaviour** in our relationships with all stakeholders.
- ❖ We value **innovation** and a relentless pursuit of **continuous improvement** in all our processes.
- ❖ We value **timely decisions** based on **facts and knowledge**.
- ❖ We value a **team-oriented** approach.
- ❖ We value the personal **safety** of all stakeholders.
- ❖ We believe in treating all stakeholders with **dignity and respect**.

## HPS is an unparalleled company – one of a kind.

What would co-founder Fred Hammond and his brothers think if they saw the industry leader that their small radio company has become? He would be proud that his family's 1917 vision has grown into the global company it is today. "Build the product like you were going to use it yourself" was their motto, one that you can see evident with the work ethic of each HPS employee.

Has growth been a challenge? At times it has, but the company has been able to weather economic storms due to the creation of a strong foundation that supports the future – a foundation that started in small town Guelph, Ontario, Canada with a focus on the people, a foundation that we continue to build on.

In 2001, CEO Bill Hammond (Fred's son) officially renamed the transformer division of Hammond Manufacturing to Hammond Power Solutions. Bill continues to steer the company his ancestors created with the same values that they began with.

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# A Future of Growth and Expansion

## Maintaining Momentum

14%

Increase in YTD Bookings Rates

## Strategic Capital Investment

\$5M

Investment YTD in Capacity and Product Development

## Expanding our Global Footprint

40%

Increase in YTD International Sales

## Cash Generation

\$10M

Increase in YTD Cash Generated by Operations

3

## Fellow Shareholders,

Hammond Power Solutions Inc. ("HPS") has battled through another quarter of turbulence and challenging market conditions. Despite earlier predictions of the global economy improving in the second half of the year, the expected recovery particularly in the United States ("U.S.") and Canada, has not materialized. As a result, our sales and profits suffered in the third quarter.

Our hardest hit markets have been those involved in the extraction of commodities and those Original Equipment Manufacturers (OEM's) who export equipment and systems abroad. Business in these areas has dropped significantly over the last eighteen months; although during the last quarter, this free fall seems to have bottomed. This has also been a very slow two-year period for non-residential construction projects in Canada. The expected bounce in construction after the very tough winter did not transpire as a number of projects were delayed into 2015 and in some cases indefinitely.

Despite these difficult challenges, our North American distributor sales continue to improve and have become a larger part of our business platform. Our operations in both Europe and India are

beginning to see positive traction after several years of expanding our market coverage as well as building on global customer and product synergies.

Going forward, we are acutely aware of the continuing uncertainty surrounding global economic growth rates, as well as the impact of falling energy and commodity prices. This is the second consecutive year where the predicted acceleration in economic growth has failed to materialize. In response, we have reduced staffing and expenses in an effort to improve profits, while at the same time continue to work on several significant product development projects. These include the long awaited launch of our North American cast transformer line which has been in development for two years, as well as the sizeable resource and capital investments required to meet new U.S. energy efficiency regulations that come into effect at the beginning of 2016. Positively, we see continued growth from our distributor channel on top of an accelerating rate of growth in Europe and India, which will assist in offsetting the slowdown in those weaker North American markets.



**William G. Hammond**  
CHAIRMAN OF THE BOARD &  
CHIEF EXECUTIVE OFFICER

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Hammond Power Solutions Inc. ("HPS" or the "Company") is a North American leader in the design and manufacture of custom electrical engineered magnetics, as well as a leading manufacturer of 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 leader in the electrical and electronic industries. The Company has manufacturing plants in Canada, the United States, Mexico, Italy and India.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

The following is Management's Discussion and Analysis ("MD&A") of the Company's consolidated operating results for the nine months ended September 27, 2014, and should be read in conjunction with the unaudited Condensed Interim Consolidated Financial Statements of the Company for the third quarter of Fiscal 2014. This information is based on Management's knowledge as at October 30, 2014. The Company assumes that the reader of this MD&A has access to and has read the audited Annual Consolidated Financial Statements and MD&A of the Company, contained in our 2013 Annual Report and accordingly, the purpose of this document is to provide a third quarter update to the information contained in the Fiscal 2013 MD&A. All amounts are reported under International Financial Reporting Standards ("IFRS"). 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](http://www.sedar.com), or on the Company's website at [www.hammondpowersolutions.com](http://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. Operating earnings and 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 and EBITDA in making investment decisions about the Company and to measure its operational results. A reconciliation of EBITDA to earnings from operations for the quarters ending September 27, 2014 and September 28, 2013 is contained in the MD&A. EBITDA should not be construed as a substitute for net income 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 may not be comparable to similar measures presented by other companies.

## Sales

Sales for the quarter-ended September 27, 2014 were \$61,558, an increase of \$4,165 or 7.3% from Quarter 3, 2013 sales of \$57,393. Year-to-date sales were \$183,227 in 2014 and \$180,137 in 2013, an increase of \$3,090 or 1.7%.

U.S. sales grew \$3,529 or 11.0% and were \$35,608 for Quarter 3, 2014 compared to \$32,079 in Quarter 3, 2013. Momentum continued, as U.S. sales increased \$672 or 1.9% from Quarter 2, 2014 sales of \$34,936. Year-to-date U.S. sales were \$104,291 in 2014 compared to \$103,280 in 2013, an increase of \$1,011 or 1.0%. Improvements in quarter and year-to-date sales is fueled by an expansion in market share in the distributor channel. 2013 comparatives were as a result of lower order booking rates and overall decline in sales activity in the Original Equipment Manufacturer ("OEM") market and Canadian project business, primarily in the drives systems, mining and capital equipment market segments. The Company continues to aggressively increase both its market share and sales through distributor conversions. This increase has also been buoyed by a modestly improved North American Electrical Distributor ("NAED") market, construction, alternative energy and oil and gas market segments in the quarter. Stated in U.S. dollars ("USD"), sales in the U.S. were \$32,442 in Quarter 3, 2014 an increase of \$1,561 or 5.1% from Quarter 3, 2013. Year-to-date sales were \$95,081 versus \$101,073, a decrease of \$5,992 or 5.9% and were also favourably affected by a 4.8% weaker Canadian dollar ("CAD"), (\$1.00 USD = \$1.09 CAD in Quarter 3, 2014 compared against \$1.00 USD = \$1.04 CAD in Quarter 3, 2013). This exchange rate change had a favourable impact on the amount of stated U.S. sales for this quarter as compared to Quarter 3, 2013.

Canadian sales were \$18,318 for the quarter, a decline of \$1,485 or 7.5% from Quarter 3, 2013 Canadian sales of \$19,803 and remain stable from Quarter 2, 2014 sales of \$18,635. Year-to-date sales were \$54,883 in 2014 compared to \$59,685 in 2013, a decrease of \$4,802 or 8.0%. Canadian sales continue to be pummeled by lower business activity in several market segments, particularly the power and mining project markets and fewer institutional construction projects. The Canadian distributor channel continues to remain softer than anticipated for the year.

International sales continued to expand in Quarter 3, 2014 finishing at \$7,632 versus \$5,511 in Quarter 3, 2013, an increase of \$2,121 or 38.5%. The rise in international sales was a result of higher OEM sales in both India and Europe over the same quarter last year. On a year-to-date basis, international sales are gaining traction, increasing \$6,881 or 40.1% over 2013 sales of \$17,172 compared to 2014 sales of \$24,053.

Quarter 3, 2014 sales stated by geographic segment were derived from U.S. sales of 57.8% of total sales, Canadian sales of 29.8%, European sales of 7.4%, and Indian sales of 5.0%. Year-to-date, 56.9% of the Company's sales were generated in the U.S., 30.0% in Canada, 7.5% within Europe and 5.6% in India.

The Company is unwavering in its focus on growth initiatives in strategic market segments, new product development, product breadth and uncompromised quality standards. Strategic acquisitions over the past several years have built a foundation for global expansion.

The Company expects it will produce sales opportunities leading to growth through existing and new customer sales. Management is confident that future sales growth will be achieved through the combination of our market expansion initiatives, our solid position in the distributor channel and our manufacturing capabilities.

## Order bookings and backlog

The Company increased bookings 7.9% over Quarter 3, 2013 due primarily to stronger "NAED" bookings in the U.S. distributor channel. Year-to-date bookings were 14.4% higher due to the increased U.S. distributor and European and Indian markets OEM bookings.

Booking rates in the distributor channel continue to accelerate as evidenced by an increase of 3.3% when compared to the previous quarter, 3% higher versus Quarter 3, 2013 and a year-to-date increase of 13.2%. On a direct channel basis, bookings exceeded Quarter 3, 2013 by 13.9% and were 15.6% higher on a year-to-date basis.

Backlog finished lower by 5.8% when compared to Quarter 2, 2014 which was 15.1% lower than the end of Quarter 3, 2013 as the product order mix continues to swing toward shorter lead time distributor channel orders.

Quotation activity continues to increase despite the continued soft general world economy and uninspiring North American "OEM" market conditions. This bodes favorably going forward, as the Company is now seeing a longer term booking horizon.

It is expected that the Company's strategic sales initiatives, expanded distributor network and new products will result in a growing improvement in our booking rates. We are cognizant that although we may experience some booking rate volatility, HPS will realize a lift in booking rates going forward.

## Gross Margin

Gross margin rates for Quarter 3, 2014 were 22.2% compared to Quarter 3, 2013 which finished at 24.7%. Year-to-date, the margin rate was 22.9% in 2014, a slight decrease from the 2013 rate of 24.2%. The Company continues to protect its gross margin rates despite a less favourable product mix, market pricing pressures and lower than anticipated manufacturing throughput.

It is important to note that the Company has invested in its capacity expansion initiatives in support of future sales growth, geographic diversification and new product development. The Company is steadfast in its growth strategies despite the shorter-term dilutive effect these investments have on gross margin rates, particularly during down turn economies. As manufacturing throughput increases, there is an accretive effect on margin rates which bodes well as sales increase. Gross margin rates are being negatively impacted by selling price pressures due to weak market conditions. The Company is witnessing

unsustainable pricing from many of its competitors in the market place. Gross margin rates are supported by the maintenance of market price combined with material procurement and engineering cost reduction initiatives, which contributed approximately 0.3% to margin rates.

This quarter has shown modest signs of economic improvement. The vacillating economic environment and slow global recovery have hurt margin rates. The Company has implemented a number of cost reduction activities including manufacturing expense variable capacity reductions. HPS continues to advance its geographic footprint, manufacturing capabilities and new product development, despite negative pressures. Our diversified geographic approach supports the anticipated growth from implemented market strategies and eventual economic improvement. In the short-term, the additional fixed costs associated with the expansion are dilutive to net margin rates. However as sales grow, the favourable impact that higher manufacturing throughput will have on the absorption of our factory overheads will positively affect margin rates. The Company's capacity expansion strategy is paramount for future increased sales demand. The Company is unyielding in obtaining increased productivity improvements, cost reductions and lead-time improvements in the entire organization. The Company is confident that these actions, combined with increased sales and higher manufacturing throughput will improve margin rates.

### Selling and distribution expenses

Total selling and distribution expenses were \$7,014 in Quarter 3, 2014 or 11.4% of sales versus \$6,536 in Quarter 3, 2013 or 11.4% of sales, an increase of \$478 or 7.3%. The majority of the change is attributed to increased sales in the quarter and the associated variable commission and freight costs. This increase amounts to \$204 or 42.7% of the change, with \$188 or 39.3% of the increased spending related to the foreign exchange translation of our U.S. dominated expenses. Year-to-date selling and distribution expenses were \$21,045 or 11.5% of sales in 2014, compared to \$19,695 or 10.9% in 2013, an increase of \$1,350 or 6.9% and is also attributed to increased sales in the year and associated variable commission and freight costs. These expenses represent \$222 or 16.4% of the change and \$744 or 55% of the increased spending related to the foreign exchange translation of our U.S. denominated expenses.

### General and administrative expense

The general and administrative expenses for Quarter 3, 2014 totaled \$5,710 or 9.3% of sales, consistent with Quarter 3, 2013 expenses of \$5,704 or 9.9% of sales. Year-to-date general and administrative expenses were \$16,914 or 9.2% of sales in 2014, compared to \$17,015 or 9.4% of sales in 2013, a decrease of \$101 or 0.6%. The quarter change was \$20 and \$82 or 81.2% of the year-to-date change related to the foreign exchange translation of our U.S. denominated expenses.

General and administrative expense management is a focus area for the Company.

### Earnings from operations

Quarter 3, 2014 earnings from operations was \$915, a decrease of \$1,006 or 52.4% from \$1,921 for the same quarter last year. The decline in the quarter is a result of lower gross margin rates, reduced gross margin dollar contribution and higher selling and distribution expenses. The year-to-date earnings from operations were \$3,988 in 2014 compared to \$6,879 in 2013, a decrease of \$2,891 or 42.0%. The lower year-to-date operating income is a result of a decline in gross margin rates and an increase in selling and distribution expenses.

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

	Quarter 3, 2014	Quarter 3, 2013	YTD 2014	YTD 2013
Net earnings	\$ 260	\$ 792	\$ 1,716	\$ 3,209
Add:				
Income tax expense	69	671	1,167	2,569
Net finance and other costs	586	458	1,105	1,101
Earnings from operations	\$ 915	\$ 1,921	\$ 3,988	\$ 6,879

### Interest expense

Interest expense for Quarter 3, 2014 finished at \$251, an increase of \$8 or 3.3% compared to the Quarter 3, 2013 expense of \$243. Year-to-date interest cost was \$767, an increase of \$62 or 8.8% when compared to the 2013 year-to-date expense of \$705. Interest expense is being generated as a result of higher operating debt levels related to the assumption of debt associated with the 2013 acquisition of Marnate and working capital requirements. Interest expense includes all bank fees.

## Foreign exchange gain/loss

The foreign exchange loss in Quarter 3, 2014 was \$303. This loss relates primarily to the transactional exchange pertaining to the Company's U.S. dollar trade accounts payable in Canada, compared to a foreign exchange loss of \$183 in Quarter 3, 2013. For the first nine months of 2014, the Company realized a foreign exchange loss of \$240 compared to a foreign exchange loss of \$297 for the same period in 2013.

As at September 27, 2014, the Company had outstanding foreign exchange contracts in place for 10,700 Euros ("EUR") and \$6,500 USD – both implemented as a hedge against translation gains and losses on inter-company loans as well as \$12,000 USD to hedge the U.S. dollar denominated accounts payable in Canadian operations of HPS.

## Income taxes

Quarter 3, 2014 income tax expense was \$69 as compared to \$671 in Quarter 3, 2013, a decrease of \$602 or 89.7%. Year-to-date income tax expense was \$1,167 in 2014 and \$2,569 in 2013, a decrease of \$1,402 or 54.6%.

The consolidated effective tax rate for Quarter 3, 2014 was 21.0% versus 45.9% for Quarter 3, 2013, a decrease of 24.9%. The year-to-date effective tax rate for 2014 was 40.5% and 44.5% for 2013, a decrease of 4.0%. The changes in the effective tax rates between the current and prior year is due to a change in the earnings mix of the Company. This change is generated from different tax jurisdictions and is subject to different tax rates and regulations. The effect of minimum tax regulations in Italy contributed to the elevated effective tax rate in the prior year.

Deferred tax assets and liabilities, consisting mainly of reserves and allowances are related to temporary differences on current assets and liabilities and are not deductible against current year earnings. Deferred tax assets and liabilities relate to temporary differences resulting from intangible assets and the difference between the net book value and un-depreciated capital cost of property, plant and equipment.

## Net earnings

Net earnings for Quarter 3, 2014 decreased by \$532 or 67.2% and finished at \$260 compared to net earnings of \$792 in Quarter 3, 2013. This decline in the quarter is a result of lower gross margin rates, reduced gross margin dollar contribution and higher selling and distribution expenses. Year-to-date net earnings were \$1,716 in 2014 and \$3,209 in 2013, a decrease of \$1,493 or 46.5%. Quarter and year-to-date results have been impacted by lower gross margin rates, reduced gross margin dollar contribution as well as higher selling and distribution expenses. While margin rates continue to be a challenge, the Company continues to anticipate further improvements going forward as it increases traction with its operational and strategic initiatives.

## EBITDA

EBITDA for Quarter 3, 2014 was \$2,234 versus \$3,380 in Quarter 3, 2013 a decrease of \$1,146. Adjusted for foreign exchange losses, EBITDA for Quarter 3, 2014 was \$2,537 versus \$3,563 in Quarter 3, 2013, a decrease of \$1,026 or 28.8%.

Year-to-date EBITDA was \$8,806 in 2014 and \$12,076 in 2013, a decrease of \$3,270 or 27.1%. Adjusted year-to-date EBITDA was \$9,046 in the current year, a decrease of \$3,327 or 26.9% from \$12,373 in 2013.

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

	Quarter 3, 2014	Quarter 3, 2013	YTD 2014	YTD 2013
Net earnings	\$ 260	\$ 792	\$ 1,716	\$ 3,209
Add:				
Interest expense	251	243	767	705
Income tax expense	69	671	1,167	2,569
Depreciation and amortization	1,654	1,674	5,156	5,593
<b>EBITDA</b>	<b>\$ 2,234</b>	<b>3,380</b>	<b>8,806</b>	<b>12,076</b>
Deduct:				
Foreign exchange loss	303	183	240	297
<b>Adjusted EBITDA</b>	<b>\$ 2,537</b>	<b>\$ 3,563</b>	<b>\$ 9,046</b>	<b>\$ 12,373</b>

Summary of Quarterly Financial Information (Unaudited)

Fiscal 2014 Quarters (Stated Per IFRS)	Quarter 1, 2014	Quarter 2, 2014	Quarter 3, 2014	YTD Total
Sales	\$ 59,953	\$ 61,716	\$ 61,558	\$ 183,227
Net earnings	\$ 520	\$ 936	\$ 260	\$ 1,716
Net income per share – basic	\$ 0.04	\$ 0.08	\$ 0.02	\$ 0.14
Net income per share – diluted	\$ 0.04	\$ 0.08	\$ 0.02	\$ 0.14
Average U.S. to Canadian exchange rate	\$ 1.101	\$ 1.092	\$ 1.087	\$ 1.093

Fiscal 2013 Quarters (Stated Per IFRS)	Q1, 2013	Q2, 2013	Q3, 2013	Q4, 2013	Total
Sales	\$ 63,672	\$ 59,072	\$ 57,393	\$ 62,804	\$ 242,941
Net earnings	\$ 1,907	\$ 510	\$ 792	\$ 2,895	\$ 6,104
Net income per share – basic	\$ 0.16	\$ 0.04	\$ 0.07	\$ 0.25	\$ 0.52
Net income per share – diluted	\$ 0.16	\$ 0.04	\$ 0.07	\$ 0.25	\$ 0.52
Average U.S. to Canadian exchange rate	\$ 1.007	\$ 1.022	\$ 1.038	\$ 1.026	\$ 1.0290

Sales in Quarter 3, 2014 have increased from 2013 due to the timing of some commercial construction projects as well as small improvements in general economic conditions. The year-to-year quarterly fluctuations in both sales and income are affected by the changes in Canadian foreign exchange rates, product mix, changing economic conditions and competitive pricing pressures.

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### Capital resources and liquidity

Net cash provided by operating activities for Quarter 3, 2014 was \$11,415 versus \$3,021 in Quarter 3, 2013, an increase of \$8,394. This increase is as a result of a decrease in income tax payments, lower net income and a decrease in working capital. Year-to-date cash generated by operating activities was \$13,662 in 2014 and \$3,439 in 2013, a difference of \$10,223.

During the quarter, non-cash working capital generated cash of \$9,189 compared to \$438 for the same quarter last year. The year-to-date change in non-cash working capital was generation of cash of \$5,736 in 2014 compared to usage of cash of \$3,055 in 2013. The working capital changes are primarily related to a decrease in inventories, an increase in trade accounts payable and foreign exchange impacts on working capital changes.

Capital expenditures were \$1,596 in Quarter 3, 2014 compared to \$983 for Quarter 3, 2013, an increase of \$613. Year-to-date capital expenditures were \$4,273 in the current year compared to \$4,754 in 2013. The Company continues to invest in the areas of manufacturing processes and capabilities, new product development and information technology.

Total cash used in financing activities for Quarter 3, 2014 was \$2,400 as compared to cash generated in financing activities of \$711 in Quarter 3, 2013. Year-to-date financing activities have used cash of \$4,379, compared to cash generated of \$5,995 for the first nine months of 2013. Bank operating lines of credit have increased from prior year levels finishing Quarter 3, 2014 at \$25,994 compared to \$21,597 at the end of Quarter 3, 2013, an increase of \$4,397. Year-to-date the bank operating lines have decreased by \$1,189.

The Company's overall debt, net of cash was \$14,976 in Quarter 3, 2014 compared to a net debt position of \$15,431 in Quarter 3, 2013, a decrease in debt position of \$455 due to the change in non-cash working capital. The cash balance at September 27, 2014 was \$15,508, an increase of \$7,783 from the balance of \$7,725 for the same period in 2013. All bank covenants continue to be met as at September 27, 2014.

The Company will utilize its cash generated from operations combined with the existing available credit facilities to finance the ongoing business operational cash requirements for working capital, capital expenditures and investing activities going forward.

## Accumulated other comprehensive income

Changes to the accumulated other comprehensive income ("AOCI") balance include foreign currency translation differences relating to the net assets of foreign operations.

## Contractual obligations

(tabular amounts in thousands of dollars)	2014	2015	2016	2017	2018	Thereafter	Total
Operating leases	\$ 2,147	\$ 1,467	\$ 856	\$ 145	\$ 99	\$ –	\$ 4,714
Accounts payable and accrued liabilities	42,063	–	–	–	–	–	\$ 42,063
Capital expenditure purchase commitments	4,693	6,374	–	–	–	–	\$ 11,067
Bank operating lines	25,994	–	–	–	–	–	\$ 25,994
Long-term debt	648	89	3,753	–	–	–	\$ 4,490
Total	\$ 75,545	\$ 7,930	\$ 4,609	\$ 145	\$ 99	\$ –	\$ 88,328

## Contingent liabilities

In December 2013, the Company 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.

## 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 1992 internal control integrated framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("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 generally accepted accounting principles. 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.

During Quarter 3, 2014 there were no material changes identified in HPS' internal controls over financial reporting that had materially affected, or was 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.

On May 14, 2013 the COSO Framework released an updated version of the 1992 internal control integrated framework, referred to as "2014 COSO". The original framework will be available through December 15, 2014, at which time the 1992 framework will be superseded. The Company continues with its process of reviewing the changes to the framework and is currently developing a transition plan adapting the new framework for the fiscal year ending December 31, 2014.

## Regular quarterly dividend declaration

The Board of Directors of HPS declared a quarterly cash dividend of six cents (\$0.06) per Class A Subordinate Voting Share of HPS and a quarterly cash dividend of six cents (\$0.06) per Class B Common Share of HPS payable on September 25, 2014 to shareholders of record at the close of business on September 18, 2014. The ex-dividend date was September 16, 2014. Year-to-date, the Company has paid a cash dividend of eighteen cents (\$0.18) per Class A Subordinate Voting Share and eighteen cents (\$0.18) per Class B Common Share.

## Risks and uncertainties

As with most businesses, HPS is subject to a number of market-place, industry and economic related business risks, which could have some visible impact on our operating results. These risks include:

- The volatility, unpredictability and cyclical effects of market costs and supply pressures for commodities including, but not limited to, copper, insulation and electrical grain oriented steel;
- A significant global unexpected change in demand for resources;
- Instability in currency rates, particularly the Canadian dollar versus the U.S. dollar;
- Global economic decline or recession;
- Fluctuations in interest rates;
- Unpredictable weather trends and conditions;
- Government protectionism or regulation changes;
- Competition;
- Credit risk; and
- Global political unrest.

The Company is very cognizant of these risks and continually assesses the current and potential impacts that they have on the business. HPS strives to minimize or eliminate 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.

There are, however, several risks that deserve particular attention:

### Commodity prices

An area that has an impact on the Company's costs and earnings is the cyclical effects and market cost pressures of copper commodity and steel pricing in the global markets. In the past, the Company had utilized a future hedging strategy, which was later discontinued due to the unprecedented volatility of the financial impact of unrealized gains and losses. Strategic supply line agreements and alliances are in place with our major steel suppliers to ensure adequate supply and competitive market pricing.

### Foreign exchange

As the Company has expanded its global footprint, the impact of foreign currency fluctuations has continued to be an area of focus. HPS operating results are reported in Canadian dollars; however the majority of our sales and material purchases are denominated in U.S. dollars. There is a natural hedge with sales denominated in U.S. dollars partially offset by the cost of raw materials purchased from the U.S., as well as commodities tied to U.S. dollar pricing. Even with this natural hedge, a change in the value of the Canadian dollar against the U.S. dollar will impact earnings. The Company's results in general, show a beneficial impact with a lower value for the Canadian dollar compared to the U.S. dollar. Inversely, a higher value for the Canadian dollar compared to the U.S. dollar will have a

corresponding negative impact on the Company's profitability.

The Company has a U.S. operating subsidiary and U.S. dollar assets as the exchange rate between the Canadian and U.S. dollar can vary significantly from year-to-year.

The recent acquisitions in Italy and India have created assets to be denominated in Euros and Indian Rupees. There is a corresponding positive or negative impact to the Company's Statement of Comprehensive Income solely related to the foreign exchange translation of its entities Balance Sheets.

We can hedge the impact of foreign exchange fluctuations through a change in our U.S. dollar driven manufacturing output. The Company has lessened its intercompany loan transactional exchange rate risk by entering into forward foreign exchange contracts.

HPS periodically institutes price increases to help offset the negative impact of changes in foreign exchange and product cost increases.

### Unpredictable weather/natural disasters

Extreme weather conditions such as heavy rains, flooding, snowfall, tornadoes and hurricanes may negatively impact the Company's order booking and sales trends.

The Company may see short-term effects of such occurrences due to their unpredictability. This may impact delivery and capacity requirements.

### Interest rates

There has been an increase in the operating line balances relating to our recent acquisitions and therefore an increase in interest costs. The Company has structured its debt financing to take advantage of the current lower interest rates, but is cognizant that a rise in interest rates will negatively impact the financial results of the Company. The Company continuously reviews its interest rate strategy and with current lower short-term interest rates has not entered into any long-term contracts.

As part of hedging this risk, the Company may enter into fixed long-term rates on part of its total debt. The Company believes that a more significant impact of a rise in interest rates would apply to our customers' investment decisions and financing capabilities.

### Credit

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

### Global/North American economy

The current economic conditions require the Company to be agile in order to continue to be successful. HPS is able to respond quickly to both unexpected opportunities and challenges. We also believe that the growing access to a variety of global and domestic markets through our OEM and distributor channels will help HPS expand market share during this economic slowdown.

Given the negative economic environment, particularly in North America, we are focusing our efforts on projects that will increase our cost competitiveness, capacity and improve our manufacturing flexibility.

### Off-balance sheet arrangements

The Company has no off-balance sheet arrangements, other than operating leases disclosed in Notes to the Consolidated Financial Statements contained in our 2013 Annual Report.

### Transactions with related parties

The Company had no transactions with related parties in 2014, other than transactions disclosed in Note 9 in the Condensed Notes to the Condensed Consolidated Interim Financial Statements contained in our Quarter 3, 2014 Report.

### Proposed transactions

The Company continues to evaluate potential business expansion initiatives, and has no firm transactions as at September 27, 2014.

### Financial instruments

As at September 27, 2014 the Company had outstanding foreign exchange contracts in place for 10,700 EUR and \$6,500 USD with both implemented as a hedge against translation gains and losses on inter-company loans as well as \$12,000 USD to hedge the U.S. dollar denominated accounts payable in Canadian operations of HPS.

### Critical accounting estimates

The preparation of the Company's condensed consolidated interim 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 value 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:

8,916,624	Class A Shares
2,778,300	Class B Common Shares
<u>11,694,924</u>	<u>Total Class A and B Shares</u>

### New accounting pronouncements

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

### Financial instruments

In October 2010, the International Accounting Standards Board ("IASB") issued IFRS 9, Financial Instruments ("IFRS 9"). This standard is part of a wider project to replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset or liability. In 2013, the IASB issued under IFRS 9 a more principles based general hedging model that aligns hedge accounting more closely with risk management. The IASB currently has an active project to make limited amendments to the classification and measurement requirements of IFRS 9 that proposes to introduce another measurement category, fair value through comprehensive income for financial assets that are held for both the collection of cash flows and for sale and add new requirements to address the impairment of financial assets and macro hedge accounting. The mandatory effective date is not yet determined; however, early adoption is still permitted. When an entity adopts IFRS 9, it will have an accounting policy change to defer application of the general hedge accounting model until the standard from the IASB's project on macro hedge accounting is effective.

The Company does not intend to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2014. The classification and measurement of the Company's financial assets and financial liabilities is not expected to change under IFRS 9 because of the nature of the Company's operations and the types of financial assets and liabilities that it holds.

## Strategic direction and outlook

HPS is dedicated to its strategic investment in growth initiatives in Canada, the U.S., India and Europe. This commitment is evidenced by the Company's international acquisitions, capacity expansion strategies, new product development and increased capital spending for strategic projects.

The poor global economic climate has had a pervasive effect on HPS. The negative impact of an erratic and unpredictable economy, as well as the variability of manufacturing throughput, raw material commodity costs and market pricing pressures has affected the Company. These deterrents are being managed through the Company's strategic projects and operational plans.

The Company's shorter term operational and financial performance has been hindered by these negative influences over the past few quarters. The Company is confident however, that the business fundamentals that have been developed will sustain and grow HPS in the near future and over the long-term. The Company's reaction to these conditions continues to be prudent but not complacent, conservative but progressive. HPS is seeing the results of these key initiatives having a positive impact. The Company will be unwavering in its pursuit of improving productivity gains, cost reduction, sales growth from new product development, geographic diversification, capacity flexibility and escalation of market share.

We continue to be an industry leader, remain financially and operationally strong, able to navigate through the enduring economic uncertainty and confident in our vision of the future.

Our approach to improving profitability includes geographic manufacturing dispersion, global expansion, sales growth, productivity gains, new product development and market share penetration.

The Company is positioned to meet the evolving needs of our traditional markets while becoming a leading player in a growing number of market sectors. Our resilience, drive and commitment, decades of experience, engineering expertise, solid supplier relationships and a broad and unique business perspective gained through our diverse products, customers and markets are key success factors.

While we expect sales growth to continue to be realized in several of our markets, we also are aware that it may remain at a lower level in others. As a portion of our sales will come from major customer projects for which the exact timing is hard to predict, we may continue to experience quarterly sales fluctuations.

The Company is committed to ensuring our strategic advantage going forward through:

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

HPS is committed to delivering escalating improvement in its financial results. We believe in the strength of HPS' strategies and are confident in the Company's ability to successfully execute its plan.

Management is firmly committed to delivering long-term value to our shareholders while contributing profitable growth and remains focused on the success of all stakeholders of the company. •

## Selected Annual and Quarterly Information

The information contained in the following table presents the historic audited annual financial information as at December 31 and the unaudited financial information for the previous eight quarters up to, and including the Third Quarter of 2014. The quarterly information has been extracted from our unaudited consolidated financial statements, which in the opinion of Management are prepared in accordance with the IFRS accounting framework as noted.

### Annual Information

(tabular amounts in thousands of dollars)	2009	2010 IFRS Restated	2011	2012	2013
Sales	195,437	190,604	221,323	257,376	242,941
Earnings from operations	18,943	13,642	13,039	18,180	11,036
EBITDA	19,816	19,500	15,538	24,352	16,924
Net earnings	9,631	10,652	5,993	12,611	6,104
Total assets	106,597	118,643	137,520	160,049	186,878
Total liabilities	29,094	32,360	46,072	58,404	77,827
Total cash (debt)	10,024	17,694	1,681	(990)	(21,104)
Cash provided (used) from operations	26,418	14,109	6,592	21,371	765
Basic earnings per share	0.82	0.92	0.52	1.08	0.52
Diluted earnings per share	0.82	0.91	0.51	1.08	0.52
Dividends declared and paid	1,173	1,504	1,738	2,098	2,328
Average Exchange Rate (USD\$=CAD\$)	1.145	1.030	0.989	1.0005	1.029
Book value per share	6.57	7.45	7.89	8.54	9.17

### Quarterly Information

(tabular amounts in thousands of dollars)	2012		2013				2014		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	63,703	62,533	63,672	59,072	57,393	62,804	59,953	61,716	61,558
Earnings from operations	4,215	5,545	3,359	1,599	1,921	4,157	1,303	1,770	915
EBITDA	5,999	6,484	5,442	3,254	3,380	4,848	3,310	3,262	2,234
Net earnings	2,552	4,730	1,907	510	792	2,895	520	936	260
Total assets	151,018	160,049	170,729	170,131	169,261	186,878	185,863	182,373	191,435
Total liabilities	53,178	58,404	65,830	64,359	65,364	77,827	73,169	72,155	78,861
Total cash (debt)	(9,255)	(990)	(18,934)	(20,552)	(19,823)	(21,104)	(24,965)	(23,419)	(14,976)
Cash provided (used) by operations	3,763	10,461	(1,011)	1,429	3,439	(3,092)	(1,645)	3,892	11,415
Basic earnings per share	0.21	0.41	0.16	0.04	0.07	0.25	0.04	0.08	0.02
Diluted earnings per share	0.21	0.41	0.16	0.04	0.07	0.25	0.04	0.08	0.02
Dividends declared and paid	–	1,049	582	582	582	582	700	700	700
Average Exchange Rate (USD\$=CAD\$)	1.000	0.9913	1.0065	1.014	1.038	1.048	1.101	1.097	1.087
Book value per share	8.24	8.54	8.82	8.91	8.75	9.17	9.47	9.24	9.44

Condensed Consolidated Statements of Financial Position

(unaudited)

(tabular amounts in thousands of dollars)	As at	
	September 27, 2014	December 31, 2013
<b>Assets</b>		
Current assets		
Cash	\$ 15,508	\$ 11,224
Accounts receivable	48,540	49,302
Inventories	36,846	39,327
Income taxes recoverable	2,340	2,887
Prepaid expenses and other assets	6,874	2,619
<b>Total current assets</b>	<b>\$ 110,108</b>	<b>\$ 105,359</b>
Non-current assets		
Property, plant and equipment	\$ 47,692	\$ 47,264
Investment in properties	1,044	1,044
Deferred tax assets	377	363
Goodwill	17,876	17,557
Intangible assets	14,338	15,291
<b>Total non-current assets</b>	<b>81,327</b>	<b>81,519</b>
<b>Total assets</b>	<b>\$ 191,435</b>	<b>\$ 186,878</b>
<b>Liabilities</b>		
Current liabilities		
Bank operating lines of credit	\$ 25,994	\$ 27,183
Accounts payable and accrued liabilities	42,063	39,216
Income tax liabilities	28	25
Provisions	416	307
Derivative liabilities	14	19
Current portion of long-term debt (note 6)	648	857
<b>Total current liabilities</b>	<b>\$ 69,163</b>	<b>\$ 67,607</b>
Non-current liabilities		
Employee future benefits	\$ 258	\$ 204
Provisions	100	100
Long-term debt (note 6)	3,842	4,288
Deferred tax liabilities	5,498	5,628
<b>Total non-current liabilities</b>	<b>9,698</b>	<b>10,220</b>
<b>Total liabilities</b>	<b>\$ 78,861</b>	<b>\$ 77,827</b>
Shareholders' Equity		
Share capital (note 7)	13,800	13,611
Contributed surplus	2,316	2,133
Accumulated other comprehensive income (note 8)	2,884	(524)
Retained earnings	91,346	91,794
<b>Total shareholders' equity attributable to equity holders of the Company</b>	<b>\$ 110,346</b>	<b>\$ 107,014</b>
Non-controlling interests	2,228	2,037
<b>Total shareholder's equity</b>	<b>112,574</b>	<b>109,051</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 191,435</b>	<b>\$ 186,878</b>

See accompanying notes to condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Earnings

(unaudited)

(tabular amounts in thousands of dollars)	Quarter ending		Nine months ending	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Sales	\$ 61,558	\$ 57,393	\$ 183,227	\$ 180,137
Cost of sales	47,919	43,232	141,280	136,548
Gross margin	13,639	14,161	41,947	43,589
Selling and distribution	7,014	6,536	21,045	19,695
General and administrative	5,710	5,704	16,914	17,015
Earnings from operations	915	1,921	3,988	6,879
Finance and other costs (income):				
Interest expense	251	243	767	705
Foreign exchange loss	303	183	240	297
Other	32	32	98	99
Net finance and other costs	586	458	1,105	1,101
Income before income taxes	329	1,463	2,883	5,778
Income tax expense	69	671	1,167	2,569
Net earnings	\$ 260	\$ 792	\$ 1,716	\$ 3,209
Non-controlling interests	\$ 35	\$ 15	\$ 64	\$ 89
Net income attributable to equity holders of the Company	225	777	1,652	3,120
Net earnings	\$ 260	\$ 792	\$ 1,716	\$ 3,209
Earnings per share				
Basic earnings per share (dollars)	\$ 0.02	\$ 0.07	\$ 0.14	\$ 0.27
Diluted earnings per share (dollars)	\$ 0.02	\$ 0.07	\$ 0.14	\$ 0.27

See accompanying notes to condensed consolidated interim financial statements.

Condensed Consolidated Statements of Comprehensive Income

(unaudited)

(tabular amounts in thousands of dollars)	Quarter ending		Nine months ending	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Net earnings	\$ 260	\$ 792	\$ 1,716	\$ 3,209
Other comprehensive income				
Foreign currency translation differences for foreign operations	2,773	(2,121)	3,535	467
Other comprehensive income for the period net of income tax (note 8)	2,773	(2,121)	3,535	467
Total comprehensive income for the period	\$ 3,033	\$ (1,329)	\$ 5,251	\$ 3,676
Attributable to:				
Equity holders of the Company	\$ 2,940	\$ (1,211)	\$ 5,060	\$ 3,932
Non-controlling interest	93	(118)	191	(256)
Total comprehensive income for the period	\$ 3,033	\$ (1,329)	\$ 5,251	\$ 3,676

See accompanying notes to condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Changes in Equity

(unaudited) For the nine months ended September 27, 2014

	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON- CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
(tabular amounts in thousands of dollars)						
Balance, as at January 1, 2014	\$ 13,611	\$ 2,133	\$ (524)	\$ 91,794	\$ 2,037	\$ 109,051
Total comprehensive income for the year						
Net earnings	–	–	–	1,652	64	1,716
Other comprehensive income						
Foreign currency translation differences (note 8)	–	–	3,408	–	127	3,535
Total other comprehensive income	–	–	3,408	–	127	3,535
Total comprehensive income for the year	–	–	3,408	1,652	191	5,251
Transactions with shareholders, recorded directly in equity						
Share-based payment transactions	189	183	–	–	–	372
Dividends to equity holders (note 7)	–	–	–	(2,100)	–	(2,100)
Total transactions with shareholders	189	183	–	(2,100)	–	(1,728)
Balance at September 27, 2014	\$ 13,800	\$ 2,316	\$ 2,884	\$ 91,346	\$ 2,228	\$ 112,574

\*AOCI – Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements.

CONSOLIDATED FINANCIAL STATEMENTS

Condensed Consolidated Statements of Changes in Equity

(unaudited) For the nine months ended September 28, 2013

	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON- CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
(tabular amounts in thousands of dollars)						
Balance, as at January 1, 2013	\$ 13,295	\$ 1,887	\$ (3,771)	\$ 87,976	\$ 2,258	\$ 101,645
Total comprehensive income for the year						
Net earnings	–	–	–	3,120	89	3,209
Other comprehensive income						
Foreign currency translation differences (note 8)	–	–	812	–	(345)	467
Total other comprehensive income	–	–	812	–	(345)	467
Total comprehensive income for the year	–	–	812	3,120	(256)	3,676
Transactions with shareholders recorded directly in equity						
Share-based payment transactions	–	322	–	–	–	322
Dividends to equity holders (note 7)	–	–	–	(1,746)	–	(1,746)
Total transactions with shareholders	–	322	–	(1,746)	–	(1,424)
Balance at September 28, 2013	\$ 13,295	\$ 2,209	\$ (2,959)	\$ 89,350	\$ 2,002	\$ 103,897

\*AOCI – Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements.

## Condensed Consolidated Statements of Cash Flows

(unaudited)

Nine months ending

(tabular amounts in thousands of dollars)

September 27, 2014

September 28, 2013

	September 27, 2014	September 28, 2013
Cash flows from operating activities	\$ 1,716	\$ 3,209
Net earnings		
Adjustments for:		
Amortization of property, plant and equipment	3,855	4,987
Amortization of intangible assets	1,301	960
Provisions	109	(507)
Interest expense	767	705
Income tax expense	1,167	2,569
Change in unrealized gain on derivatives	(5)	(25)
Stock based compensation expense	183	322
	9,093	12,220
Change in non-cash working capital (note 10)	5,736	(3,055)
Cash provided from operating activities	14,829	9,165
Income tax paid	(1,167)	(5,726)
Net cash provided from operating activities	13,662	3,439
Cash flows from investing activities		
Acquisition of subsidiary company net of cash acquired	–	(9,512)
Acquisition of property, plant and equipment	(4,273)	(4,754)
Acquisition of intangible assets	(243)	(812)
Cash used in investing activities	(4,516)	(15,078)
Cash flows from financing activities		
(Repayment) advances of borrowings	(1,189)	9,029
Issue of common shares	189	–
Repayment of long-term debt	(512)	(583)
Cash dividends paid (note 7)	(2,100)	(1,746)
Interest paid	(767)	(705)
Cash (used in) provided by financing activities	(4,379)	5,995
Foreign exchange on cash held in a foreign currency	(483)	(351)
Increase (decrease) in cash	4,284	(5,995)
Cash at beginning of period	11,224	13,720
Cash at end of period	\$ 15,508	\$ 7,725

See accompanying notes to condensed consolidated interim financial statements.

Quarters ended September 27, 2014 and September 28, 2013 (tabular amounts in thousands of dollars)

The accompanying unaudited interim financial statements of Hammond Power Solutions Inc., (“HPS” or the “Company”) have been prepared by and are the responsibility of the Company’s Management. The Company’s independent auditor has not performed a review of these financial statements in accordance with standards adopted by the Canadian Institute of Chartered Accountants (“CICA”) for a review of interim financial statements by an entity’s auditor.

## 1. Reporting entity

Hammond Power Solutions Inc. (“HPS” or the “Company”) is a company domiciled in Canada. The address of the Company’s registered office is 595 Southgate Rd. 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 Condensed Consolidated Interim Financial Statements of the Company as at and for the third quarter ended September 27, 2014 comprise the Company and its subsidiaries (together referred to as the “Group” and individually as “Group entities”) and the Group’s interest in associates and jointly controlled entities. The Group is primarily involved in the design and manufacture of custom electrical engineered magnetics and standard electrical dry-type, cast resin, and liquid filled transformers, serving the electrical and electronic industries. The Company has manufacturing plants in Canada, the United States (“U.S.”), Mexico, Italy, and India, the latter being PETE Hammond Power Solutions Private Limited, a 70% equity ownership acquired through an acquisition during the third quarter of 2012.

## 2. Basis of preparation

### (a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with requirements of IAS 34, Interim Financial Reporting and do not include all of the information required for full annual financial statements.

These condensed consolidated interim financial statements, were approved by the Board of Directors on October 23, 2014.

### (b) Use of estimates and judgments

The preparation of the condensed consolidated interim 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.

In preparing these condensed consolidated interim financial statements, the significant judgments made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2013.

## 3. Summary of significant accounting policies:

These condensed consolidated interim financial statements should be read in conjunction with the Group’s 2013 annual audited financial statements, which are available on the System for Electronic Document Analysis and Retrieval (“SEDAR”). The significant accounting policies applied by the Company in these condensed consolidated interim financial statements are the same as those applied by the Company in its Consolidated Financial Statements as at and for the year ended December 31, 2013.

### Changes to accounting policies

The Group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of January 1, 2014.

- IAS 32 Offsetting financial assets and liabilities
- IAS 19 Defined benefit plans: employee contributions
- IAS 36 Recoverable amounts
- IFRIC 21, Levies

There was no significant impact of the adoption of these standards on the financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended September 27, 2014 and September 28, 2013 (tabular amounts in thousands of dollars)

### 4. Property, plant and equipment:

The Group had acquisitions of fixed assets for the nine months ended September 27, 2014 in the amount of \$4,273,000 of machinery and equipment (2013 - \$4,754,000).

### 5. Intangible assets

The Group had acquisitions of intangible assets for the nine months ended September 27, 2014 in the amount of \$243,000 (2013 - \$812,000), for the addition of software. None of the intangible assets have been developed internally.

### 6. Long-term debt

	Nine months ending	
	September 27, 2014	September 28, 2013
Opening balance	\$ 5,145	\$ 2,142
Repayments:		
Term loan CAD	(136)	(136)
Term loans EUR	(358)	(368)
Term loan INR	(18)	(143)
Exchange	(143)	64
	4,490	1,559
Less current portion of long-term debt	648	230
Total	\$ 3,842	\$ 1,329

### 7. Share capital

#### (a) Dividends

The following dividends were declared and paid by the Company:

	Nine months ending	
	September 27, 2014	September 28, 2013
18 cents per Class A common share (2013: 15 cents)	\$ 1,599	\$ 1,329
18 cents per Class B common share (2013: 15 cents)	501	417
	\$ 2,100	\$ 1,746

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended September 27, 2014 and September 28, 2013 (tabular amounts in thousands of dollars)

### 7. Share capital (continued)

#### (b) Stock option plan

During the nine months ended September 27, 2014, the Company granted 90,000 options (2013 – 150,000) of which 90,000 vested immediately (2013 – 90,000). Stock-based compensation recognized and the amount credited to contributed surplus during the period is \$183,000 (2013 - \$322,000) and relates to options granted during Quarter 1, 2014, and to options granted in prior years that vested during the period. The weighted average fair value of the options granted during the period is \$1.52 (2013 - \$2.37).

The grant date fair value of share-based payment plans was measured based on the Black-Scholes formula. The inputs used in the measurement of the fair values at grant date of the share-based payment plans are the following:

	2014	2013
<b>Fair value of share options and assumptions</b>		
Fair value at grant date	\$ 1.52	\$ 2.37
Share price at grant date	\$ 7.50	\$ 10.00
Exercise price	\$ 7.50	\$ 10.00
Expected volatility (weighted average volatility)	42.4%	43.6%
Option life (expected weighted average life)	3.8 years	3.8 years
Expected dividends	1.4%	1.1%
Risk-free interest rate (based on government bonds)	1.72%	1.79%

### 8. Accumulated other comprehensive income

Changes to the accumulated other comprehensive income ("AOCI") balance include foreign currency translation differences relating to the net assets of foreign operations. Total other comprehensive income for the nine months ended September 27, 2014 was \$3,408,000 (2013 – \$812,000), resulting in an ending balance of accumulated other comprehensive income of \$2,884,000 (2013 – (\$2,959,000)).

### 9. Related party transactions:

#### Related parties

Arathorn Investments Inc. beneficially owns 2,778,300 (2013 – 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 1,044,857 (2013 – 1,027,802) Class A subordinate voting shares of the Company, representing approximately 11.7% (2013 – 11.6%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. William G. Hammond, Chief Executive Officer and Chairman of the Company, owns all of the issued and outstanding shares of Arathorn Investments Inc. Total dividends paid during the quarter, directly and indirectly to William G. Hammond were \$229,000 (Quarter 3 2013– \$139,000).

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

	Note	2014	2013	Relationship
Purchase of goods and services	(i)	\$ 1,761	\$ 409	Companies in which key management personnel and/or their relatives have significant influence.

	2014	2013	Relationship
Amounts owed to related parties	\$ 531	\$ 59	Companies in which key management personnel and/or their relatives have significant influence.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended September 27, 2014 and September 28, 2013 (tabular amounts in thousands of dollars)

### Transactions with key management personnel

During the nine months ended September 27, 2014, the Company purchased \$137,000 (2013 – \$232,000) of inventory from ILSCO of Canada Limited (“ILSCO”), a company in which HPS director David J. FitzGibbon serves as a Vice Chairman and CEO. The Company purchases a component part from ILSCO, which is utilized in the manufacture of transformers. The purchases were measured at the exchange amount. Accounts payable and accrued liabilities include \$18,000 (2013 – \$nil), which is owed to this company.

- (i) During the nine months ended September 27, 2014, the Company has paid \$28,000 (2013 – \$177,000) of payments in connection with rental agreements for office space and an apartment with K. Linga Reddy and K. Ravi Reddy, the minority shareholders of PETE – Hammond Power Solutions Private Limited in India.

### 10. Change in non-cash operating working capital

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

	Nine months ending	
	September 27, 2014	September 28, 2013
Accounts receivable	\$ 762	\$ (1,699)
Inventories	2,481	(913)
Prepaid expenses	(4,255)	388
Accounts payable and accrued liabilities	2,847	(5,265)
Foreign exchange	3,901	4,434
	<b>\$ 5,736</b>	<b>\$ (3,055)</b>

# Diversified Markets Global Presence



Responding to global market changes, HPS anticipates and adapts to the needs of our customers by delivering high quality, dependable transformers for very demanding and unique applications that meet the precision needs for some of the harshest environments.

## North America

- » Dominant dry transformer provider to the Canadian market served through both the HPS and Delta brands
- » U.S. and Canadian electrical distributor channels continue to be growth markets for HPS
- » Expansion into the Mexican market via brand label arrangement
- » New technologies and product development to North America

**Industries:** Industrial, Institutional, Oil and Gas, Commercial Construction, Solar, Capital Projects

## South America

South America provides opportunities in offshore oil exploration and development as well as wind energy.

**Industries:** Oil and Gas, Wind Energy, Solar



## Europe

Acquisition and integration of Marnate with our existing Italian operation supports our global growth strategies and doubles our product offering in new global markets.

- » We anticipate greater market growth opportunities for cast product in Europe, Russia and India
- » New product development will also provide avenues for growth

**Industries:** Oil and Gas, Renewable Energy

## India and Asia

- » Broadened product capabilities
- » New technologies to these markets
- » Domestic sales growth and new market opportunities in Europe, Russia, Africa, Ethiopia, the Middle East, Israel, the Caribbean and Venezuela
- » China

**Industries:** Renewable Energy, Mining, Oil and Gas, Utilities

**Hammond Power Solutions Inc.  
Canada**

**Corporate Head Office**

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15 Industrial Road  
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Phone: (519) 881-3552

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Guelph, Ontario N1H 6H9

**Delta Transformers Inc.**

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Granby, Quebec J2G 9A1  
Phone: (450) 378-3617

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

**PETE – Hammond Power Solutions  
Private Limited  
India**

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**Euroelettro Hammond s.p.a.  
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**Marnate Trasformatori s.r.l.**

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Monterrey, Mexico

**Hammond Power Solutions, Inc.  
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Phone: (608) 356-3921

17715 Susana Road  
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Phone: (310) 537-4690

**Euroelettro Hammond s.p.a**



**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.

## Corporate Officers and Directors

### William G. Hammond \*

Chairman and Chief Executive Officer

### Christopher 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

### Richard S. Waterman \*\*

Director

### Frederick M. Jaques \*\*

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 Services Inc.

100 University Avenue

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## Auditors

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Canada N2J 5A3

## Legal Representation

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Scotia Plaza

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Toronto, Ontario

Canada M5H 3Y4

## Investor Relations

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## Banking Institution

JP Morgan Chase

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Hammond Power  
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