

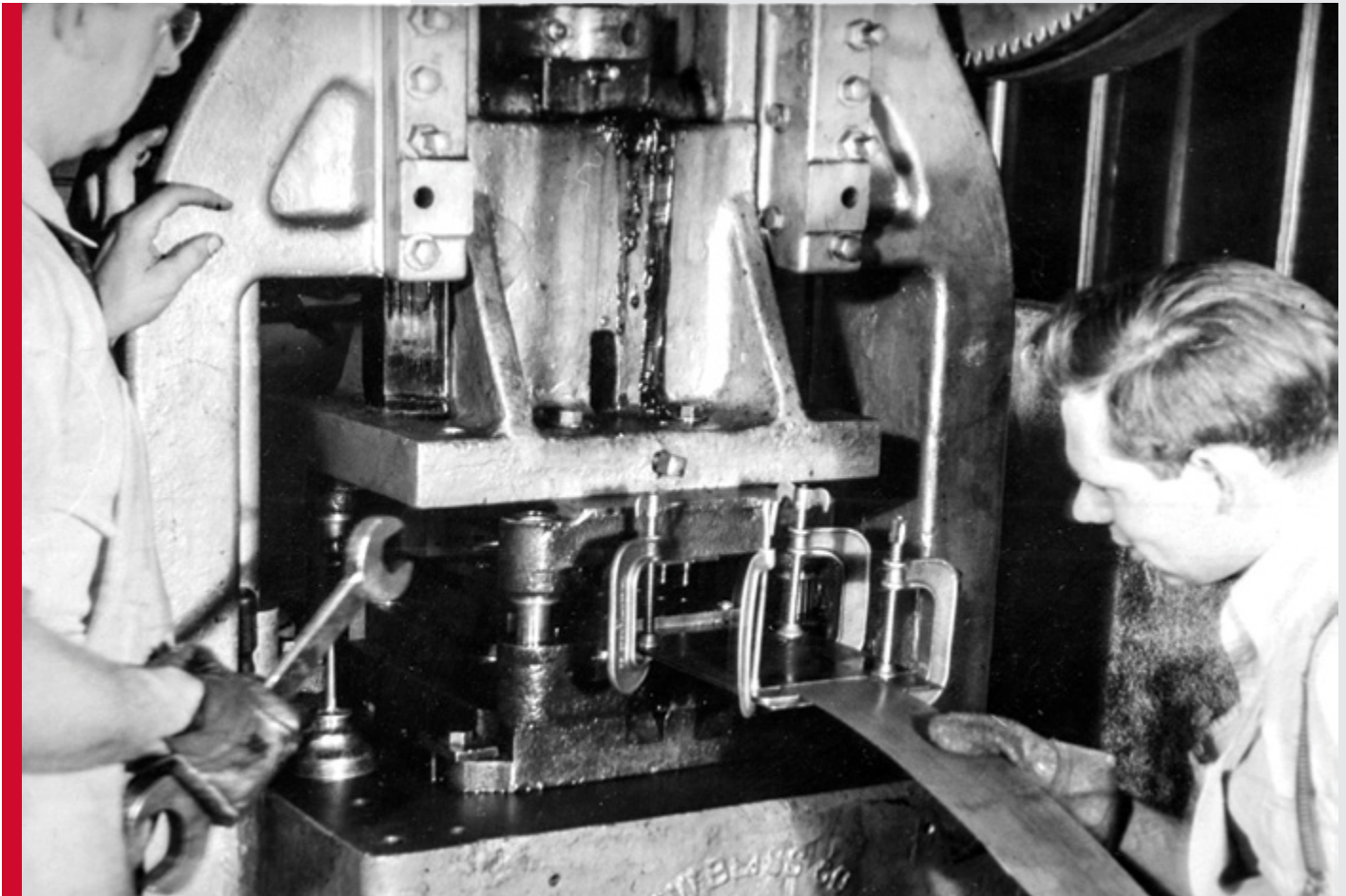
HAMMOND  
MANUFACTURING®

# 2018

ANNUAL REPORT

Over 100 Years  
& Four Generations  
Server Racks and Cabinets  
Electrical Enclosures  
Outlet Strips  
Small Enclosures  
Electronic Transformers

Over 100 years  
& four generations  
in business.  
Established 1917.



Fred Hammond, VE3HC (right) was part of the second generation of a fast growing family run business. Fred was one of six brothers and two sisters.

### Quality Products. Service Excellence.

We have a broad product offering to serve our customers in multiple markets and industries.

We promise ten day back order recovery on standard product. We work hard to provide you with your required product in a prompt time line.

Value added services (modifications, assembly and drop shipment): we go above and beyond our competition and provide our customers with the exact solution required.

### Our Values:

- We are dedicated to our customers. We provide quality products and service that create value to our customers.
- We are responsible to our shareholders. We provide an adequate return on their investment over the long term.
- We are committed to our employees. We provide competitive pay, open and frank communication and a safe work environments.
- We recognize the importance of our suppliers assisting us in our ability to serve our customers.

# Hammond Manufacturing Company Limited

## 2018 Annual Report

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## REPORT TO SHAREHOLDERS

Dear fellow shareholders, employees, and stakeholders:

In the following pages, we have explained the results for 2018 in great detail.

This analysis shows Hammond as a strong company with a number of areas for continual improvement. Cost reduction, growth of market share, and lower bank debt are all on our focus list.

I would especially like to point out that 62% of our revenues come from customers outside Canada. Moreover, our US sales growth of 14% confirms that we can be successful against our competition when we all work together.

I would also like to mention that Hammond has broad employee ownership. Shares trade on the Toronto exchange and are owned by hundreds of associates.

As you read this annual report, we are already well into 2019 and its challenges. All shareholders can be assured that our associates in all countries are keeping Hammond strong and growing.

Sincerely,



Robert F. Hammond  
Chairman & CEO

### ANNUAL MEETING

The meeting of the Shareholders will be held on  
April 29, 2019 at

Cutten Fields  
190 College Avenue East, Guelph, Ontario  
Commencing at 10:00 a.m.

## MANAGEMENT DISCUSSION AND ANALYSIS

This management discussion and analysis (MD&A) comments on the consolidated financial position and financial performance of Hammond Manufacturing Company Limited (“HMCL” or “the Company”) for the year ended December 31, 2018. This discussion should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2018 and related notes. Additional information about the Company can be found on its website, [www.hammmfg.com](http://www.hammmfg.com), or through the SEDAR website at [www.sedar.com](http://www.sedar.com) which includes the Company’s Annual Information Form. The information contained herein is dated as of March 4, 2019.

The annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

All amounts in this report are in Canadian dollars unless otherwise stated.

Advisory—Certain information in this MD&A is forward-looking and is subject to important risks and uncertainties. The results or events predicted in this information may differ from actual results or events. Forward-looking statements are often, but not always, identified by the use of words such as “anticipate”, “plan”, “estimate”, “expect”, “may”, “project”, “predict”, “potential”, “could”, “might”, “should” and other similar expressions. The Company believes the expectations reflected in forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct. These forward-looking statements speak only to the date of this MD&A. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required pursuant to applicable securities laws.

# MANAGEMENT DISCUSSION AND ANALYSIS

## COMPANY PROFILE

Hammond Manufacturing Company Limited manufactures electronic and electrical enclosures, outlet strips and electronic transformers that are used by manufacturers of a wide range of electronic and electrical products. Products are sold directly to Original Equipment Manufacturers (OEM) and through a global network of distributors and agents.

Facilities are situated in Canada, the United States of America (US), the United Kingdom (UK), Taiwan and Australia, with agents and distributors located worldwide. The Company also maintains a 40% ownership share of RITEC Enclosures Inc. (RITEC) located in Taiwan. RITEC produces a line of small cases for sale through the Hammond Manufacturing Company's sales channels and also manages sourcing of die cast and plastic enclosures.

## OPERATIONS

Our 2016 expansion has been put to good use. In 2018 we continued with smaller projects to streamline activities as our market demand continued to be strong. Shop activities outpaced the market as inventory levels were replenished and expanded to ensure we can meet our customer commitments. With lower sales in the fourth quarter the inventories are now replenished. The challenge in the first quarter of 2019 will be to keep the shop loaded for effective overhead absorption.

## QUARTERLY INFORMATION

### HAMMOND MANUFACTURING COMPANY LIMITED

#### Summary of Quarterly Financial Information

*(In thousands of Canadian dollars except earnings per share)*

	2018				Year-to-date Total
	Q1	Q2	Q3	Q4	
Net product sales	\$36,150	\$37,750	\$37,333	\$34,369	\$145,602
Income from operating activities	1,984	1,925	2,207	1,597	7,713
Net income for the period	1,097	904	1,489	274	3,764
Earnings per share - Basic & diluted	\$0.10	\$0.08	\$0.13	\$0.02	\$0.33

	2017				Year-to-date Total
	Q1	Q2	Q3	Q4	
Net product sales	\$31,727	\$33,486	\$31,421	\$30,772	\$127,406
Income from operating activities	1,449	2,282	1,032	1,210	5,973
Net income for the period	1,002	1,579	1,161	818	4,560
Earnings per share - Basic & diluted	\$0.09	\$0.14	\$0.10	\$0.07	\$0.40

Note: Interim consolidated financial information has not been reviewed by an auditor.

# MANAGEMENT DISCUSSION AND ANALYSIS

## FOURTH QUARTER RESULTS

### NET PRODUCT SALES

Net product sales, for the three months ended December 31, 2018 were \$34,369,000, down 7.9% compared to net product sales of \$37,333,000 in the third quarter of 2018. As expected, December sales were down due to holidays. This can account for 3.5% of the drop. We did feel a drop in overall activity on a daily basis compared to the third quarter although we cannot tie this to any specific event. Net product sales for the current quarter were up 11.7% compared to net product sales of \$30,772,000 for the three months ended December 31, 2017. Foreign exchange helped the current quarter compared to the last quarter by providing a currency gain of \$96,000. Foreign exchange had a positive impact on the current quarter versus the comparable quarter of 2017 by \$46,000.

### GROSS PROFIT

Gross profit of \$10,609,000 for the fourth quarter of 2018 was 30.9% of net sales compared to 29.5% in the third quarter of 2018. Despite the slowdown in sales, plant production levels remained strong as we took the opportunity to rebuild some of our depleted inventory. Price increases put in play at the end of the third quarter along with a positive foreign exchange impact helped offset material and labour cost increases as well as providing some positive margin upside. Gross profits of 30.9% are up from the fourth quarter of 2017 level of 29.9%.

### SELLING AND DISTRIBUTION, GENERAL AND ADMINISTRATIVE, RESEARCH AND DEVELOPMENT (“R&D”) EXPENSES AND LOSS (GAIN) ON DISPOSAL OF PROPERTY, PLANT AND EQUIPMENT

Fourth quarter selling and distribution, general and administrative, R&D expenses and loss (gain) on the disposal of property plant and equipment of \$9,012,000 was 26.2% of net sales for the three months ended December 31, 2018. This compared with spending of \$8,817,000 in the previous quarter that was 23.6% of net sales. Foreign exchange impact increased costs by approximately \$15,000. The fourth quarter of 2017 saw spending levels of \$7,989,000 which was 26.0% of net sales. Foreign exchange increased the expense levels by \$15,000 over this comparative period also.

Selling and distribution spending of \$7,548,000 was up 2.1% over the prior quarter and up 12.8% over the fourth quarter of 2017. Despite the drop in sales prepaid freight expenses were up quarter over quarter. Our customers continue to take full advantage of our prepaid freight offering which has been increasing our freight expenses. The increase over the fourth quarter of 2017 is primarily driven from the increase in sales.

General and administrative expenses of \$1,405,000 were up this quarter from the previous quarter's spending of \$1,321,000 and up over the fourth quarter spend of 2017 of \$1,344,000. Non-recurring restructuring costs increased the fourth quarter spend of 2018 by \$50,000. A project undertaken to upgrade our information systems hardware and software in the fourth quarter incurred \$40,000 of non-recurring expenses.

Research and development spend of \$103,000 was up from the comparative fourth quarter spend of \$59,000 in 2017. Increased staffing levels account for \$20,000 of this increase. Canadian Standards Association charges were up \$21,000 over the comparative quarter and travel expense related to training increased expense levels by \$5,000.

## MANAGEMENT DISCUSSION AND ANALYSIS

A net gain of \$44,000 on disposal of property, plant and equipment was recognized this quarter with the sale of our old punch that was fully depreciated and replaced by a modern piece of equipment

### INCOME FROM OPERATING ACTIVITIES

Income from operating activities of \$1,597,000 (4.6% of net sales) is down from the prior quarter of \$2,207,000 (5.9% of net sales) and up from the 2017 fourth quarter amount of \$1,210,000 (3.9% of net sales).

### INTEREST

Interest expense in the fourth quarter was \$607,000 compared to \$243,000 in the prior quarter. Interest expense is on the rise due to increased borrowings and a lump sum interest payment.

### FOREIGN EXCHANGE TRANSACTIONAL IMPACT

During the fourth quarter of 2018, the Company recognized a loss on transactional foreign exchange of \$675,000 compared to a gain of \$2,000 in the three months ended December 31, 2017. In 2018 the intercompany balance impact was \$420,000 of the \$675,000 loss. The spot rate at the opening of the fourth quarter of 2018 was 1.00 USD to 1.2945 CAD. The closing spot rate for 2018 was 1.00 USD to 1.3642 CAD. The opening intercompany balance payable to our US entity was almost \$6.0 million. The ending intercompany payable was \$7.6 million USD. Since the Canadian entity held the payable in US funds the 6.97 cent change in foreign exchange rates payable increased the Canadian valuation of the payable due creating a transactional expense. . There is an offset to the intercompany impact found in the foreign exchange translation of foreign operations as the offsetting US receivable is due from the Canadian entity and would be part of the translational adjustment of the US entities balance sheet on consolidation.

### INCOME TAX EXPENSE (INCOME)

The final true up for the year's activities combined with a low income before tax provided for tax income of \$24,000.

### NET INCOME (LOSS) FOR THE PERIOD

Net income of \$274,000 (0.8% return on net product sales) was recognized for the fourth quarter ended December 31, 2018 this was down from a net return of \$1,489,000 (4.0% return on net product sales) in the previous quarter and down from the net return of \$818,000 (2.7% return on net product sales) recognized in the fourth quarter of 2017.

### FOREIGN EXCHANGE TRANSLATION OF FOREIGN OPERATIONS

The translation adjustment for the fourth quarter of 2018 was a gain of \$1,036,000 compared to a translation gain of \$89,000 in the fourth quarter of 2017. The Canadian dollar weakening against our foreign entity currencies provided a positive impact from foreign translation.

### TOTAL COMPREHENSIVE INCOME

Comprehensive income for the fourth quarter ended December 31, 2018 was \$1,310,000 (3.8% of net product sales) up from the 3 months ended December 31, 2017 of \$907,000 (2.9% of net product sales) and up from the previous quarters total comprehensive income of \$1,135,000 (3.0% of net product sales).



# MANAGEMENT DISCUSSION AND ANALYSIS

## FULL YEAR RESULTS

### NET PRODUCT SALES

Net product sales of \$145,602,000 in 2018 were up 14.3% compared to net sales of \$127,406,000 reported in 2017. Foreign exchange had a positive impact on the year over year reporting by approximately \$238,000 (0.2%) so sales were actually up 14.1% in constant dollars. Price increases make up 3 to 4% of the increase so our volume increase is close to 10%. Our markets did show signs of leveling off in the fourth quarter and we are monitoring closely.

### GROSS PROFIT

In 2018, gross profit was \$43,426,000 or 29.8% of net product sales compared to \$38,006,000 or 29.8% achieved in 2017. Through price increases and efficiency improvements we were able to maintain our gross profit margin levels.

### SELLING AND DISTRIBUTION, GENERAL AND ADMINISTRATIVE, RESEARCH AND DEVELOPMENT (“R&D”) EXPENSES AND LOSS (GAIN) ON DISPOSAL OF PROPERTY, PLANT AND EQUIPMENT

Selling and distribution, general and administrative, R&D expenses including the net impact of the disposal of property, plant and equipment of \$35,713,000 (24.5% of net product sales) was up 11.5% compared to the 2017 spend of \$32,033,000 (25.1% of net product sales). Foreign exchange had the impact of increasing the reported expense levels by approximately \$65,000 compared to the cost base in 2017 so spend was actually up 11.3% compared to 2017.

Selling and distribution expenses of \$30,030,000 increased 11.2% compared to 2017. Foreign exchange had the impact of increasing comparative costs by \$47,000. On a constant dollar basis our costs were up 11.1%. Our prepaid freight program costs of \$8.6 million were up 26.3% over 2017 cost levels. Our freight program is one of our drivers to grow volume. The remaining expenses were up only 6.3% as there is a fixed expense component that provides an upside as we grow.

Our general and administrative expenses of \$5,341,000 were up \$504,000 or 10.4% compared to 2017 spending levels of \$4,837,000. Foreign exchange increased costs over 2017 by \$18,000. The year over year increases came from the following. Staff additions added \$130,000 and provision increases for bad debts of \$123,000 of which \$70,000 was related to one specific customer. Legal expenses were up \$38,000 as the defense continues for a lawsuit noted under environmental issues. We also had non-recurring restructuring charges of \$47,000. We also incurred charges for hardware and software upgrades of \$60,000 to support our computer systems. Travel and entertainment was up \$48,000 as a function of increased sales levels.

In 2018 the research and development spending level was up 30.6% to \$371,000 over 2017 spending levels. The primary driver of this increase was an addition of an employee to the department. We continue to invest in our future.

A net gain of \$29,000 on disposal of property, plant and equipment was recognized as some old equipment was sold and replaced. This compares to a net gain on disposals of \$87,000 recognized in 2017.

### INCOME FROM OPERATING ACTIVITIES

Overall, 2018 earnings from operating activities of \$7,713,000 (5.3% of net product sales) is up compared to 2017 earnings of \$5,973,000 (4.7% of net product sales).

## MANAGEMENT DISCUSSION AND ANALYSIS

### INTEREST

Interest expense of \$1,414,000 increased \$414,000 or 41.4% from the 2017 expense level of \$1,000,000. Our external debt grew throughout 2018 as we invested in our operations. External debt at the end of 2018 was \$31,210,000 up from \$22,552,000 at the end of 2017.

### FOREIGN EXCHANGE TRANSACTIONAL IMPACT

A \$1,122,000 foreign exchange transactional loss was reported in 2018, compared to a transactional gain of \$1,286,000 in 2017. The Canadian dollar weakened against the US dollar throughout 2018. It opened at \$1.00 USD to \$1.255 CAD and closed the year at \$1.00 USD to \$1.364 CAD. A large portion of the gain is from the intercompany receivable. Our Canadian entity has a payable to our US entity in US dollars. The Opening payable was \$6.9 million USD and the closing balance was \$7.6 million. This year it created transaction losses of just under \$800,000 with the offset going to translational gains of other foreign operations.

### INCOME TAX EXPENSE

2018 tax expenses of \$1,288,000 were 25.5% of income before income tax. This compares to a 2017 tax expense of \$1,827,000 which was 28.6% of income before income tax. Taxes as a percent of income before income tax improved as a direct result of the US tax rate reforms that came into play in 2018.

### NET INCOME FOR THE YEAR

Net income for the year ended December 31, 2018 was \$3,764,000 (2.6% of net product sales) down 17.5% from the prior year net income of \$4,560,000 (3.6% of net product sales).

### FOREIGN EXCHANGE TRANSLATION OF FOREIGN OPERATIONS

During 2018 a gain of \$1,532,000 on translational foreign exchange was realized compared to a loss of \$1,041,000 in 2017. The strengthening Canadian dollar caused a decrease in the valuation of our foreign entities. As noted earlier a large part of this is offset by the foreign exchange transactional impact of intercompany loans.

### TOTAL COMPREHENSIVE INCOME

Comprehensive income for 2018 was \$5,296,000 (3.6% of net product sales) up from comprehensive income of \$3,519,000 (2.8% of net product sales) in 2017.

# MANAGEMENT DISCUSSION AND ANALYSIS

## SELECTED ANNUAL INFORMATION

### Three year financial summary:

For the years ended December 31,  
(In thousands except per share amounts)

<b>Consolidated Statements of Comprehensive Income</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net product sales	\$ 145,602	\$ 127,406	\$ 115,724
Income from operating activities	7,713	5,973	2,296
Net income for the year	3,764	4,560	684
Per share - basic & fully diluted net earnings for the year	\$0.33	\$0.40	\$0.06

<b>Consolidated Statement of Financial Position</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Total assets	\$ 100,813	\$ 85,889	\$ 82,157
Total funded debt	31,210	22,552	25,186
Working capital	20,152	21,270	19,016
Net cash generated from (used in) operating activities	1,354	7,244	(3,370)
Dividends declared and paid	452	226	226
Shareholders' equity	\$ 51,401	\$ 46,557	\$ 43,264

## CAPITAL RESOURCES AND LIQUIDITY

Net cash generated in operating activities for 2018 was \$1,354,000 (net cash generated in 2017 - \$7,244,000). Cash flows from financing activities generated \$7,851,000 (2017 - use of \$2,229,000). Cash used in investing activities was \$10,614,000 (2017 - \$3,440,000).

Trade and other receivables of \$19,054,000 at December 31, 2018 have increased 17.2% compared to the 2017 year-end. Higher sales contributed to this increase. Day's sales outstanding (DSO) increased 2.2 days over the previous year end. DSO as at December 31, 2018 calculated on net sales was 53.6 days which was up from 51.4 days calculated as at December 31, 2017. Our customers continue to push for longer payment terms. The quality of accounts receivable remains high.

The year-end investment in inventory of \$40,185,000 was an increase of 15.8% from the 2017 inventory value of \$34,700,000. Inventory turnover increased slightly to 2.8 from 2.7 (cost of sales divided by the twelve month average inventory level). Our value statement of having our standard product on our shelves combined with the increasing number of stock keeping units makes for a low turn ratio.

Trade and other payables increased by \$1,647,000, or 11.7% over 2017 to \$15,728,000. The majority of this increase can be attributed to our increased output levels. Our total debt (long-term debt and bank indebtedness) increased by \$8,658,000 over the prior year to \$31,210,000. Our debt-to-equity ratio at year-end was approximately 0.61:1 (2017 - 0.48:1).

Total dividends paid in 2018 were \$452,000 (2017 - \$226,000).

Property, plant, equipment and intangible asset additions in 2018 were \$9,738,000 up from \$4,098,000 in 2017. The Company spent \$1,557,000 (2017 - \$491,000) on building and leasehold improvements. \$73,000 (2017 - \$1,003,000) was invested toward replacing machinery and equipment, \$6,906,000 (2017 - \$1,954,000) was invested toward machinery and equipment for capacity growth, \$677,000 (2017

## MANAGEMENT DISCUSSION AND ANALYSIS

- \$511,000) was invested in tooling, \$28,000 (2017 - \$1,000) was invested in office equipment. \$434,000 (2017 - \$138,000) was invested in the upgrade / replacement of our computer hardware which we run our main ERP system on. \$4,000 (2017 - \$nil) was spent on software and development costs. 2018 spending on product development of \$59,000 was up from \$nil in 2017.

In 2015, the Group successfully applied for and was approved by the Federal Economic Development Agency for Southern Ontario for an interest free loan up to \$3,461,500 on eligible spending. As at December 31, 2018, the Group had received \$3,115,000 of this funding (2017 - \$2,493,000).

In 2015, the Group successfully applied for and was approved by the Southwestern Ontario Development Fund for a grant up to \$1,500,000 on eligible spending. As at December 31, 2018, the Group has received \$989,000 of this funding (2017 - \$724,000).

The grant and government funding noted above are contingent on adding new jobs and retaining existing jobs at our Guelph, Ontario locations. As at the time of this report the Group was in compliance with this requirement and did not foresee any future compliance issues although employee levels are a function of the market conditions which can be unpredictable.

The contractual obligations of the Company are detailed in the following table.

<b>Contractual obligations</b> (In thousands)	<b>Total</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>Thereafter</b>
Long-term debt and							
Capital lease obligations	\$ 23,611	\$ 17,955	\$ 1,484	\$ 1,460	\$ 1,438	\$ 805	\$ 469
Operating leases	8,534	2,326	1,981	1,122	941	808	1,356
Total contractual obligations	\$ 32,145	\$ 20,281	\$ 3,465	\$ 2,582	\$ 2,379	\$ 1,613	\$ 1,825

\$16,874,000 of the \$19,474,000 long-term debt are demand loans and therefore are shown as due in 2019. The following table depicts the repayment obligation without the debt being called.

<b>Contractual obligations</b> (In thousands)	<b>Total</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>Thereafter</b>
Long-term debt and							
Capital lease obligations	\$ 23,611	\$ 2,216	\$ 2,670	\$ 2,699	\$ 2,733	\$ 7,764	\$ 5,529
Operating leases	8,534	2,326	1,981	1,122	941	808	1,356
Total contractual obligations	\$ 32,145	\$ 4,542	\$ 4,651	\$ 3,821	\$ 3,674	\$ 8,572	\$ 6,885

In addition to the contractual obligations above, the Company has current obligations of \$519,000 (2017 - \$4,609,000) against open purchase orders for outstanding capital expenditures. The Company also has open purchase commitments with RITEC as at December 31, 2018 of \$827,000 (2017 - \$959,000). These expenditures should be completed in the first half of 2019.

## SHARE CAPITAL

As of March 4, 2019, 8,556,000 Class A subordinate voting shares and 2,778,300 Class B common shares were issued and outstanding. The Company also has a management share option plan, with no options currently outstanding.

## EBITDA

EBITDA for the fourth quarter of 2018 was \$1,776,000 down from \$2,042,000 in the fourth quarter of 2017. If you remove the impact of the transactional impact of foreign exchange it shows as an improvement quarter over quarter (see chart below). Year to date 2018 EBITDA was \$9,808,000 down

## MANAGEMENT DISCUSSION AND ANALYSIS

\$590,000 over the \$10,398,000 achieved in 2017. EBITDA adjusted for foreign exchange shows a year over year improvement. EBITDA and adjusted EBITDA is calculated as outlined in the following table:

Reconciliation of Net Earnings to Earnings Before Interest, Taxes Depreciation and Amortization (EBITDA)\*.

<i>(In thousands of Canadian dollars)</i>	<b>Years Ended:</b>		<b>Three Months Ended:</b>	
	<b>December 31, 2018</b>	<b>December 31, 2017</b>	<b>December 31, 2018</b>	<b>December 31, 2017</b>
Net income (loss) for the period	3,764	4,560	274	818
Add				
Income tax expense	1,288	1,827	(24)	257
Depreciation and amortization	3,342	3,011	919	724
Finance costs	1,414	1,000	607	243
Subtotal	6,044	5,838	1,502	1,224
EBITDA*	9,808	10,398	1,776	2,042
Add:				
FX transactional loss (gain)	1,122	(1,286)	675	(2)
Adjusted EBITDA *	10,930	9,112	2,451	2,040

\* EBITDA and Adjusted EBITDA are non-IFRS earnings measures, therefore they do not have any standardized meaning prescribed by International Financial Reporting Standards and may not be similar to measures presented by other companies. EBITDA represents earnings before interest, income taxes, depreciation and amortization. Adjusted EBITDA removes the impact of transactional foreign exchange so management can assess the impact of this on the operating results. Management uses these measurements to evaluate the operating results of the Company. These measures are also important to management since they are used by the Company's lenders to evaluate the ongoing cash generating capability of the Company and therefore the amounts those lenders are willing to lend to the Company.

## ENVIRONMENTAL ISSUES

The Glen Ewing Property is a 50% co-tenancy with Hammond Power Solutions Inc. (HPSI) of a vacant property located at 2 Glen Road, Georgetown. The soil has been contaminated by diesel oil, which is believed to be related to site operations of prior owners. The Company and HPSI, as co-tenants, have been working co-operatively with our environmental consultant, the Ministry of Environment and the adjacent property owner to contain and remove any free flowing contaminants. The Company's share of expense for legal and consulting work for 2018 related to this property was \$89,000 (2017 - \$76,000). In 2017 the Company was successful in claiming back \$126,000 of prior and current year expenses from an adjacent property owner who is also involved in the environmental remediation. \$70,000 was for years prior to 2016, \$31,000 was for the year 2016 and \$25,000 was for 2017. The net reported expense for 2018 was \$89,000 (2017 – income of \$50,000).

The parties started remediation of the site in October 2009. The Company has relied on its consultant's best estimate for the remaining environmental remediation costs. The Company's remaining portion of environmental remediation costs for this site is \$170,000 (2017 - \$170,000) with \$70,000 (2017 - \$70,000) presented as a current liability in the consolidated financial statements.

A statement of claim was issued on June 19, 2013, against the Company with respect to a property once held by the Company. The claim alleges that contaminants originating from the property once owned by the Company have migrated to a nearby, but not adjoining property owned by the claimants. The amount

## MANAGEMENT DISCUSSION AND ANALYSIS

of the claim is not fully known but includes \$3,500,000 which is the estimated cost of construction of a barrier and related expenses. At this point in time, there is no certainty that the contaminants emanated from the property once owned by the Company. Furthermore, given the nature of the claim, there remains significant uncertainty as to any costs to be incurred as a result of the claim and accordingly management is unable to reasonably estimate any liability that may arise as a result of this claim. As such, no amount has been recorded in these consolidated financial statements. In 2017 the claim moved into the discovery proceedings level and we have seen corresponding legal fees in 2017 and 2018.

Other than the above noted sites, management is not aware of any unusual or significant environmental issues.

### CRITICAL ACCOUNTING ESTIMATES

In the preparation of the consolidated financial statements, it is necessary for management to make some estimates and judgments that affect reported amounts in the consolidated financial statements and related disclosure of contingencies. Management determines these estimates using historical experience, assumptions and rationale that are believed to be reasonable in the circumstances. The Company evaluates these on an ongoing basis in order to form the judgment for the carrying value of certain assets and liabilities.

Specifically, the Company has assessed the property valuations related to the sites noted under "Environmental Issues" in this MD&A and in the notes to the consolidated financial statements (note 8). Based on this analysis, it is management's judgment that the reported carrying values of these properties are reasonable.

The value of goodwill related to the Company's UK operations was reviewed by management and tested for impairment in accordance with the guidelines set out in International Accounting Standard 36. Based on this analysis, it is management's judgment that the reported carrying value for goodwill is not impaired.

The environmental provision has been established based on an analysis of cost estimates related to expected activities required for active remediation for Glen Ewing Property. It is management's judgment that the reported carrying value for this provision, based on discounted cash flows over three years, is a reasonable estimate of the Company's share of these costs given information available at this time, but acknowledges that this estimate is subject to future uncertainties.

Employee future health benefits have been estimated based on eligible employees and management's best estimates of the utilization of these benefits on a specific employee basis. It is management's judgment that the reported carrying value for this provision, based on discounted cash flows, is a reasonable estimate of the Company's costs given information available at this time, but acknowledges that this estimate is subject to future uncertainties.

Inventory valuation includes provisions for slow moving inventory using management's judgments based on inactivity of the specific parts. Management also reviews inventory values compared to anticipated sales values and provides a provision for lower of cost or net realizable value.

Although these estimates, which form the basis for carrying values of reported assets, liabilities, revenues and expenses, are based on reasonable assumptions, it should be noted that actual results may differ from these estimates.

# MANAGEMENT DISCUSSION AND ANALYSIS

## CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to management on a timely basis so that appropriate decisions can be made regarding public disclosure.

The purpose of internal controls over financial reporting as defined by the Canadian Securities Administrators is to provide reasonable assurance that:

- (i) financial statements prepared for external purposes are in accordance with the Company's Generally Accepted Accounting Principles,
- (ii) transactions are recorded as necessary to permit the preparation of financial statements, and records are maintained in reasonable detail,
- (iii) receipts and expenditures of the Company are made only in accordance with authorizations of the Company's management and directors, and
- (iv) unauthorized acquisitions, uses or dispositions of the Company's assets that could have a material effect on the financial statements will be prevented or detected in order to prevent material error in financial statements.

Internal controls over financial reporting, no matter how well designed have inherent limitations. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### Evaluation of Disclosure Controls and Procedures:

Management is responsible for establishing and maintaining disclosure controls and procedures. Under the supervision and with the participation of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), management evaluated the effectiveness of the Company's disclosure controls and procedures. Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in annual filings, interim filings or other reports filed or submitted by the Company under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed in the annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to management, including the Company's certifying officers, as appropriate to allow timely decisions regarding required disclosure. Management concluded that the Company's disclosure controls and procedures were effectively designed as at the December 31, 2018 year end.

### Evaluation of Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining internal control over financial reporting. Under the supervision and with the participation of the Company's CEO and the CFO, management evaluated the effectiveness of the Company's internal control over financial reporting. Internal control is a process designed by, or under the supervision of, an issuer's certifying officers, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS and includes those policies and procedures that: (a) pertain to the

## MANAGEMENT DISCUSSION AND ANALYSIS

maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) are designed to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the IFRS, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) are designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the annual financial statements or interim financial statements. The CEO and CFO did not identify any material weaknesses in their evaluation of internal control, and concluded that the Company's internal control over financial reporting was effective, as at December 31, 2018.

There has been no change to internal controls in the most recent quarter ended on December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## RISKS AND UNCERTAINTIES

As with most businesses, the Company is subject to a number of marketplaces, industry and economic related business risks, which could have some material, impact on our operating results.

These risks include:

- Security Breaches or Disruptions of Information Technology Systems Risk;
- Key personnel;
- The cyclical effects, unpredictability and volatility of market driven commodity costs, raw materials such as copper and steel pricing and supply and demand;
- A significant, unexpected change in the global demand for resources;
- The variability of the Canadian dollar versus the US dollar;
- Rising interest rates;
- Economic slowdown in the US and Canada;
- Brexit;
- Trade restrictions;
- Labour costs and labour relations;
- Competition; and
- Global political unrest.

The Company continuously works to minimize the negative impact of these risks and strengthen its position through diversification of its core business, market channel expansion, geographic diversity of its operations and business hedging strategies. There are, however, several risks that deserve particular attention.

### Security Breaches or Disruptions of Information Technology Systems Risk

The Corporation utilizes a variety of information technology systems to manage and operate its businesses. These information systems may be owned and maintained by the Corporation, outsource providers or third parties such as customers, vendors and contractors. These information systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines and networking equipment. Despite the implementation of extensive security



## MANAGEMENT DISCUSSION AND ANALYSIS

measures (including access controls, data encryption, vulnerability assessments, continuous monitoring, and maintenance of back-up and protective systems), the Corporation's information technology systems are potentially vulnerable to interruptions or delays, unauthorized access, computer viruses, cyber-attack and other events, ranging from individual attempts to advanced persistent threats. It is possible a security breach could result in theft of trade secrets or other intellectual property or disclosure of confidential customer, supplier or employee information. Should the Corporation be unable to prevent security breaches, disruptions could have an adverse effect on the Corporation's operations and financial results, as well as expose the Corporation to litigation, increased cyber security protection costs, and reputational damage.

### Key Personnel

The Company is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plan. If the Company were to experience a substantial turnover in its leadership or other key employees, business results from operations and financial condition could be materially adversely affected.

### Commodity Prices

An area that has had a definite effect on the Company's costs and earnings is the cyclical effects and unprecedented market cost pressures of copper commodity and steel pricing in the global market. Due to this unpredictability and volatility, particularly with copper pricing, the Company does not currently utilize future contracts. Strategic supply line agreements and alliances are in place with our major steel suppliers to ensure adequate supply and competitive market pricing.

### Foreign Exchange

The Company's operating results are reported in Canadian dollars. A significant portion of our sales is denominated in US dollars. A change in the value of the Canadian dollar against the US dollar will impact revenues and earnings. We have created a bit of a natural hedge as this is partially offset by a corresponding change in the cost of materials purchased from the US and commodities tied to US dollar pricing. In general, a lower value for the Canadian dollar compared to the US dollar will have a beneficial impact on the Company's results; or, inversely, a higher value for the Canadian dollar compared to the US dollar will have a negative impact on the Company's profitability. In a sensitivity review, if we did not react in any way to a one cent change in the value of the Canadian to US dollar value it would have an approximate impact of \$679,000 for each cent movement. The Company also has a US operating subsidiary and US dollar assets. The exchange rate between the Canadian and US dollar can vary significantly from year to year. There is a corresponding positive or negative impact to the Company's Consolidated Statements of Comprehensive Income solely related to the foreign exchange translation of its Consolidated Statements of Financial Position. We have partially reduced the impact of foreign exchange fluctuations through increasing our US dollar driven manufacturing output. Finally, the Company periodically institutes price increases / reductions to help offset the negative / positive impact of changes in foreign exchange and product cost increases / decreases. The Company is also exposed

## MANAGEMENT DISCUSSION AND ANALYSIS

to the impact from the British pound sterling and Euro as well as to the Australian dollar but not to the level of exposure of the US dollar.

### Interest Rates

Bank indebtedness makes up close to 24.3% of the Company's debt financing. The rates for this financing are low but variable. The Company is cognizant that a rise in interest rates will negatively impact the financial results of the Company. The Company continuously reviews this strategy of hedging this risk by fixing interest rates on part of its total debt.

### North American Economy

Over the past several years the US dollar compared to the Canadian dollar has ranged from the low 1.20's to the high 1.30's Canadian dollar to US dollar ratio. A strengthening US market place has contributed to the strengthening US dollar. Since our costs are highly Canadian dollar based, this is providing an opportunity to price aggressively in the US market place and increase our market activity. Current outlook sees the US dollar remaining strong. We will continue to react to the market conditions to grow our business. Our efforts over the next 12 months will continue to be on projects that will reduce our costs and improve our manufacturing flexibility. We believe that being nimble as an organization will become even more important in order to respond quickly to both unexpected opportunities as well as challenges. We also believe that our growing access to a variety of markets both global and domestic through our OEM and distributor channels will help the Company expand market share.

### Global Political Unrest

Today's politics can have significant repercussions on doing business. Issues are constantly changing and management has to assess the potential outcomes of the different issues and be prepared to react or mitigate anything that would have a negative impact on our business. In 2018 the North American Trade Agreement was under negotiation signed on November 30, 2018. It still needs to be ratified. US tariffs put in place on steel are still in play despite have the agreement in place.

BREXIT is currently playing out overseas. We have operations in the UK that service the UK and Europe. The landscape of doing business will more than likely change as a result of the situation although no one can determine what the final result will look like. Management is closely watching the situation and is looking at different options for doing business overseas.

## ACCOUNTING POLICY CHANGES

### IFRS 9 Financial instruments

Effective January 1, 2018, the Company adopted IFRS 9 on a retrospective basis, which sets out requirements for recognition and measurement, impairment, derecognition of financial instruments and general hedge accounting. This standard simplifies the classification of a financial asset as either at amortized cost or at fair value as opposed to the multiple classifications which were permitted under IAS 39. This standard also requires the use of a single impairment method as opposed to the multiple methods in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The standard also adds guidance on the classification and measurement of financial liabilities.

Cash and trade and other receivables that were classified as loans and receivables under IAS 39 are classified as financial assets measured at amortized cost. There is no change to the initial measurement of the Company's financial assets. Impairment of financial assets is based on an expected credit loss

## MANAGEMENT DISCUSSION AND ANALYSIS

(“ECL”) model under IFRS 9, rather than the incurred loss model under IAS 39. ECLs are a probability weighted estimate of credit losses. The Company calculated ECLs based on consideration of customer specific factors and actual credit loss experience. As a percentage of revenue, the Company’s actual credit loss experience has not been significant.

The adoption of IFRS 9 has not had an effect on the Company’s accounting policies related to financial liabilities.

There was no material impact of transition to IFRS 9 on the Company’s statement of financial position at January 1, 2018.

### **IFRS 15 Revenue from contracts with customers**

The Company has adopted IFRS 15 with a date of initial application of January 1, 2018. IFRS 15 includes a single, five-step revenue recognition model that requires entities to recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The standard also requires more informative, relevant disclosures. IFRS 15 supersedes IAS 11 “Construction Contracts” and IAS 18 “Revenue”, as well as various IFRIC and SIC interpretations regarding revenue. The Company has applied IFRS 15 using the cumulative effect method (without practical expedients) and therefore the comparative information has not been restated and continues to be reported under IAS 11 and IAS 18. The adoption of IFRS 15 did not result in a in significant differences between the point of risk and rewards transfer for the sale of product under IAS 18, and the point of transfer of control under IFRS 15, therefore no transition adjustments were recognized as at January 1, 2018. As a result of the adoption of IFRS 15, the Company’s accounting policies have been updated, and additional disclosure has been included. See note 2 to the consolidated financial statements for these changes in accounting policies. IFRS 15 had no impact on the Company’s consolidated statement of income for the year ended December 31, 2018.

### **Future Accounting Changes**

The International Accounting Standards Board (IASB) issued the following standards that have not been applied in preparing the consolidated financial statements and notes thereto, for the year ended December 31, 2018 as their effective dates fall within annual periods beginning subsequent to the current reporting period: IFRS 16 “Leases” and IFRIC 23 “Uncertainty over Income Tax Treatments”.

### **IFRS 16 Leases**

In January 2016 the IASB issued IFRS 16, Leases. The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities from all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Group intends to adopt IFRS 16 in its consolidated financial statements for the annual and interim reporting periods beginning on January 1, 2019. The extent of the impact of adoption of this standard has yet to be determined.

## MANAGEMENT DISCUSSION AND ANALYSIS

### **IFRIC 23 *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 in which there is uncertainty over income tax treatments.

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 predictions of the resolution;
- an entity to determine if it is probable that the tax authorities will accept the 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 Interpretation is applicable for annual and interim reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

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

### **OUTLOOK FACTORS FOR 2019**

The fourth quarter showed signs of slowing. Our current market expectation is to see stable growth in all our market places although at a slower pace than we had been experiencing. The strong US dollar continues to provide us the opportunity to competitively price our products and stimulate market share growth. The Company continues with the objective of sales growth and increased market share but will weigh this against achieving acceptable margins.

Capital spending will continue to be focused on high impact projects as accommodated by cash flows.

Our primary focus continues to be on productivity and margin improvement.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements are the responsibility of the management of Hammond Manufacturing Company Limited. These statements have been prepared in accordance with International Financial Reporting Standards, 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 the consolidated financial statements and other financial information contained in the report. In the preparation of these statements, estimates are 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 assurance 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 for financial reporting and internal control. The Board of Directors is assisted in exercising its responsibilities through the Audit Committee of the Board, which is composed of three 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.

R.F. Hammond



Chairman & CEO

A. Stirling



Secretary & CFO

Guelph, Ontario

March 4, 2019



KPMG LLP  
115 King Street South  
2nd Floor  
Waterloo ON N2J 5A3 Canada  
Tel 519-747-8800  
Fax 519-747-8830

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Hammond Manufacturing Company Limited

### ***Opinion***

We have audited the consolidated financial statements of Hammond Manufacturing Company Limited (the Entity), which comprise:

- The consolidated statements of financial position as at December 31, 2018 and 2017
- the consolidated statements of comprehensive income 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 financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the “financial statements”).

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Entity as December 31, 2018 and 2017, 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 consolidated 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.

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. KPMG Canada provides services to KPMG LLP.



### ***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 likely to be entitled "Glossy Annual Report".

Our opinion on the consolidated 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 consolidated 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 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.

The information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Glossy Annual Report" is expected to be made available to us after the date of this auditors' report. If, based on the work we will perform on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact to those charged with governance.

### ***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 International Financial Reporting Standards (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 consolidated 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 consolidated 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 consolidated 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 consolidated financial statements, including the disclosures, and whether the consolidated 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*

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Chartered Professional Accountants, Licensed Public Accountants

The engagement partner on the audit resulting in this auditors' report is Ian J. Jeffreys.

Waterloo, Canada

March 4, 2019

# HAMMOND MANUFACTURING COMPANY LIMITED

## Consolidated Statements of Financial Position

(in thousands of Canadian dollars)

As at December 31,	Note	2018	2017
<b>Assets</b>			
<b>Current assets:</b>			
Cash		\$ 625	\$ 1,051
Trade and other receivables	4	19,054	16,261
Income taxes receivable		453	-
Inventories	5	40,185	34,700
Prepaid expenses		1,312	1,181
<b>Total current assets</b>		<b>61,629</b>	<b>53,193</b>
<b>Non-current assets:</b>			
Property, plant and equipment	6	37,059	30,629
Intangible assets and goodwill	7	284	269
Investment property	8	1,044	1,044
Equity investment	9	797	754
<b>Total non-current assets</b>		<b>39,184</b>	<b>32,696</b>
<b>Total assets</b>		<b>\$ 100,813</b>	<b>\$ 85,889</b>
<b>Liabilities</b>			
<b>Current liabilities:</b>			
Bank indebtedness	10	\$ 7,599	\$ 5,716
Trade and other payables	11	15,728	14,081
Income taxes payable		-	918
Current portion of provisions	12	124	115
Current portion of employee future benefits	13	71	53
Current portion of long-term debt	10	17,955	11,040
<b>Total current liabilities</b>		<b>41,477</b>	<b>31,923</b>
<b>Non-current liabilities:</b>			
Employee future benefits	13	209	237
Long-term debt	10	5,656	5,796
Provisions	12	100	100
Deferred tax liabilities	14	1,970	1,276
<b>Total non-current liabilities</b>		<b>7,935</b>	<b>7,409</b>
<b>Total liabilities</b>		<b>49,412</b>	<b>39,332</b>
<b>Equity:</b>			
Share capital	15	10,249	10,249
Contributed surplus		290	290
Accumulated other comprehensive income		3,407	1,875
Retained earnings		37,455	34,143
<b>Total equity</b>		<b>51,401</b>	<b>46,557</b>
Commitments	16 & 17		
Contingency	18 & 24		
<b>Total liabilities and equity</b>		<b>\$ 100,813</b>	<b>\$ 85,889</b>

The notes on pages 30 to 64 are an integral part of these consolidated financial statements.

# HAMMOND MANUFACTURING COMPANY LIMITED

## Consolidated Statements of Comprehensive Income

(in thousands of Canadian dollars, except earnings per share)

For The Years Ended December 31,	Note	2018	2017
Net product sales		\$ 145,602	\$ 127,406
Cost of sales		102,176	89,400
<b>Gross profit</b>		<b>43,426</b>	<b>38,006</b>
Selling and distribution		30,030	26,999
General and administrative		5,341	4,837
Research and development		371	284
Gain on disposal of property, plant and equipment		(29)	(87)
<b>Income from operating activities</b>		<b>7,713</b>	<b>5,973</b>
Interest expense	10	(1,414)	(1,000)
Foreign exchange gain (loss)		(1,122)	1,286
<b>Net finance income (expense)</b>		<b>(2,536)</b>	<b>286</b>
Share of profit of equity accounted investees	9	(36)	78
Share of recovery (expenses) from investment property	8	(89)	50
<b>Income before income tax</b>		<b>5,052</b>	<b>6,387</b>
Income tax expense	19	1,288	1,827
<b>Net income for the year</b>		<b>3,764</b>	<b>4,560</b>
Other comprehensive gain (loss):			
Foreign currency translation differences for foreign operations		1,532	(1,041)
Other comprehensive income (loss) for the year, net of income tax		1,532	(1,041)
<b>Total comprehensive income for the year</b>		<b>\$ 5,296</b>	<b>\$ 3,519</b>
<b>Earnings per share</b>			
Basic earnings per share	20	\$ 0.33	\$ 0.40
Diluted earnings per share	20	\$ 0.33	\$ 0.40

The notes on pages 30 to 64 are an integral part of these consolidated financial statements.

# HAMMOND MANUFACTURING COMPANY LIMITED

Consolidated Statements of Changes in Equity  
For the years December 31, 2018 and December 31, 2017  
(in thousands of Canadian dollars)

	Attributable to equity holders of the Company				
	Share Capital	Contributed Surplus	AOCI**	Retained earnings	Total equity
Balance at January 1, 2017	\$ 10,249	\$ 290	\$ 2,916	\$ 29,809	\$ 43,264
Net income for the year	-	-	-	4,560	4,560
Other comprehensive loss:					
Foreign currency translation differences	-	-	(1,041)	-	(1,041)
<b>Total comprehensive income (loss) for the year</b>	<b>-</b>	<b>-</b>	<b>(1,041)</b>	<b>4,560</b>	<b>3,519</b>
Transactions with owners, recorded directly in equity:					
Dividends to equity holders	-	-	-	(226)	(226)
<b>Balance at December 31, 2017</b>	<b>\$ 10,249</b>	<b>\$ 290</b>	<b>\$ 1,875</b>	<b>\$ 34,143</b>	<b>\$ 46,557</b>
Balance at January 1, 2018	\$ 10,249	\$ 290	\$ 1,875	\$ 34,143	\$ 46,557
Net income for the year	-	-	-	3,764	3,764
Other comprehensive loss:					
Foreign currency translation differences	-	-	1,532	-	1,532
<b>Total comprehensive income (loss) for the year</b>	<b>-</b>	<b>-</b>	<b>1,532</b>	<b>3,764</b>	<b>5,296</b>
Transactions with owners, recorded directly in equity:					
Dividends to equity holders	-	-	-	(452)	(452)
<b>Balance at December 31, 2018</b>	<b>\$ 10,249</b>	<b>\$ 290</b>	<b>\$ 3,407</b>	<b>\$ 37,455</b>	<b>\$ 51,401</b>

\*\* Accumulated other comprehensive income (loss)

The notes on pages 30 to 64 are an integral part of these consolidated financial statements.

# HAMMOND MANUFACTURING COMPANY LIMITED

## Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

For the Years Ended December 31,	2018	2017
<b>Cash flows from operating activities</b>		
Net income for the year	\$ 3,764	\$ 4,560
Adjustments for:		
Depreciation of property, plant and equipment	3,289	2,955
Amortization of intangible assets	53	56
Interest expense	1,414	1,000
Income tax expense	1,288	1,827
Gain on disposal of property, plant and equipment	(29)	(87)
Provisions and employee future benefits	10	-
Equity investments	(43)	(116)
	9,746	10,195
Change in non-cash working capital:		
Inventories	(5,232)	(1,899)
Trade and other receivables	(2,181)	(1,068)
Prepaid expenses	(117)	(54)
Trade and other payables	2,289	1,057
<b>Cash generated from operating activities</b>	<b>4,505</b>	<b>8,231</b>
Interest paid	(1,300)	(915)
Income tax paid	(1,851)	(72)
<b>Net cash generated from operating activities</b>	<b>1,354</b>	<b>7,244</b>
<b>Cash flows from financing activities</b>		
Bank indebtedness	1,875	(1,635)
Payment of long-term debt	(1,336)	(1,326)
Advances of long-term debt	7,764	958
Payment of dividends	(452)	(226)
<b>Net cash generated (used) from financing activities</b>	<b>7,851</b>	<b>(2,229)</b>
<b>Cash flows from investing activities</b>		
Proceeds from disposal of property, plant and equipment	44	94
Acquisition of property, plant and equipment	(10,595)	(3,534)
Intangible asset additions	(63)	-
<b>Net cash used in investing activities</b>	<b>(10,614)</b>	<b>(3,440)</b>
<b>Net increase (decrease) in cash</b>	<b>(1,409)</b>	<b>1,575</b>
Cash at beginning of year	1,051	614
<b>Foreign exchange gain (loss) on cash and cash equivalents in a foreign currency</b>	<b>983</b>	<b>(1,138)</b>
Cash at end of year	\$ 625	\$ 1,051

The notes on pages 30 to 64 are an integral part of these consolidated financial statements.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

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## 1) Reporting entity:

Hammond Manufacturing Company Limited (“HMCL” or the “Company”) is a public company traded on the Toronto Stock Exchange under the symbol “HMM.A” and is incorporated under the Ontario Business Corporations Act. The address of the Company’s registered office is 394 Edinburgh Road North, Guelph, Ontario. The consolidated financial statements of the Company as at and for the year ended December 31, 2018 include the Company and its subsidiaries (together referred to as the “Group” and individually as “Group entities”) and the Group’s interest in jointly controlled entities. The Group primarily is involved in the design, manufacture and sale of electrical and electronic components. Facilities are located in Canada, the US, the UK, Taiwan and Australia, with agents and distributors located worldwide. The Company also maintains a 40% ownership share of RITEC Enclosures Inc. (RITEC) located in Taiwan. RITEC produces plastic and die cast enclosures for sale through the Company’s sales network and its own existing market channels.

## 2) Basis of preparation:

### a) Statement of compliance:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The Board of Directors approved these consolidated financial statements on March 4, 2019.

### b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis.

### c) Functional and presentation currency:

The consolidated financial statements are presented in Canadian dollars. 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 statement of comprehensive income. 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 months during which the transactions occurred. Foreign currency translation differences are recognized in other comprehensive income which is included in accumulated other comprehensive income. The functional currency of the Company’s subsidiary operations located in the US, UK, Taiwan and Australia are the US dollar, the British pound sterling, Taiwan dollar and the Australian dollar respectively. The functional currency of the Company’s Canadian operations is the Canadian dollar.

### d) Use of estimates:

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

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

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estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Management periodically reviews its estimates and underlying assumptions relating to the following items:

i) Amortization

Management makes estimates of the appropriate useful lives to be assigned to intangible assets based on the individual circumstances of an acquisition. Management reviews the appropriateness of the lives assigned and makes adjustments prospectively, where necessary.

ii) Impairment tests

Management makes estimates of sustainable earnings, future expected cash flows and discount rates in the determination of the value-in-use or fair value less costs of disposal of cash-generating units ("CGUs").

iii) Provision against accounts receivable

Management makes estimates on the expected credit losses ("ECLs") of accounts receivable balances based on customer specific facts and circumstances as well as past experience of write-offs. Changes in the economic conditions in which the Company's customers operate and their underlying financial stability may impact these estimates.

iv) Employee future benefits

Management estimates the discount rates, retirement age and future costs of benefits associated with providing future employee benefits and exercises judgment to determine how many employees will utilize these benefits.

v) Tax assets

Deferred tax assets and liabilities contain estimates about the nature and timing of future permanent and temporary differences as well as the future tax rates that will apply to those differences. Changes in tax laws and rates as well as changes to the expected timing of reversals may have a significant impact on the amounts recorded for deferred tax assets and liabilities. Management closely monitors current and potential changes to tax law and bases its estimates on the best available information at each reporting date.

vi) Depreciation

Management estimates future residual values and the rate at which the useful lives of property and equipment are consumed to determine appropriate depreciation charges. Estimates of residual value and useful lives are based on data and information from various sources, including vendors, industry practice and Company-specific history. Management reviews the appropriateness of the lives assigned and makes adjustments prospectively, where necessary.

vii) Stock options

Management makes estimates with respect to risk-free rates of return, expected volatility, expected dividends, expected life of options, expected forfeitures and future market conditions to calculate the fair value of stock options.

# HAMMOND MANUFACTURING COMPANY LIMITED

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viii) Property value

Management estimates the value of the investment property to assess if impairment has occurred. The estimate is made by reviewing local land prices and current sales of similar properties as well as property tax value assessment.

ix) Environmental remediation:

Management estimates the value to complete the remediation project on the Glen Ewing Property each year by reviewing the project status and activities still to be completed. Any changes to the project scope are updated in the cost estimation model and any change in the required reserve is booked in the current year.

x) Sales returns:

Management estimates the value of product that will be returned based on a historical analysis. Any change to the estimate is recorded as a reduction of revenue in the current period.

e) Use of judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments that affect the application of accounting policies and the interpretation of accounting standards. Management periodically reviews its judgments and underlying assumptions relating to the following items:

i) Provision for claims

Judgment is exercised in deciding whether a liability for a claim meets the criteria of a present obligation and in assessing the probability of the outflow of economic resources.

ii) Lease classification

The Company enters into leases for premises and operating equipment that may be classified as operating or finance leases. Management exercises judgment to determine whether substantially all the risks and rewards incidental to ownership have been transferred to the Company.

iii) Impairment tests

Management exercises judgment to determine whether there are factors that would indicate that an asset or a CGU is impaired. The determination of CGUs is also based on management's judgment and is an assessment of the smallest group of assets that generate cash inflows independently of other assets. Factors considered include whether an active market exists for the output produced by the asset or group of assets as well as how management monitors and makes decisions about the Company's operations.

iv) Intangible assets

Management exercises judgment to determine whether identifiable intangible assets were acquired in a business combination, separate from goodwill and whether they will provide future economic benefits to the Company.



# HAMMOND MANUFACTURING COMPANY LIMITED

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## 3) Summary of significant accounting policies:

Except for the changes explained in “new standards and interpretations adopted” below, the accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements. These accounting policies have been consistently applied by all Group entities.

### a) Basis of consolidation:

The consolidated financial statements include the accounts of Hammond Manufacturing Company Limited, its wholly owned subsidiaries, Hammond Manufacturing Company Inc., Hammond Electronics Limited, Hammond Electronics Pty Limited, Les Fabrications Hammond (Quebec) Inc., Hammond Electronics Asia Limited and its proportionate share of the Glen Ewing Property, an unincorporated co-tenancy (50%). All significant intercompany balances and transactions have been eliminated on consolidation. The consolidated financial statements include the investment in RITEC, which is accounted for using the equity method.

### b) Revenue recognition:

The Company determines revenue recognition through the following steps: a) identification of the contract with a customer, b) identification of the performance obligations in the contract, c) determination of the transaction price, d) allocation of the transaction price to the performance obligations in the contract and e) recognition of revenue when the Company satisfies a performance obligation.

The Company principally generates revenue through the manufacturing and sale of industrial enclosures, electronic enclosures, racks and cabinets, transformers and other products. Revenue is recognized when control of a product is transferred to a customer. This is generally at the point in time when product is available for physical delivery, and the customer has legal title to, physical possession of (or through their carrier), and the risks and rewards of ownership of the product have transferred; therefore, the customer is able to direct the use of and obtain substantially all of the benefits of the product. There is only a single performance obligation, except for where delivery is provided by Hammond after the point of transfer.

Revenue is measured based on the consideration specified in a contract with a customer, net of variable consideration, including rebates, returns and discounts. Rebates are accrued using sales data and rebate percentages specific to each customer contract. Accruals for sales returns are calculated based on the best estimate of the amount of product that will ultimately be returned by customers. All customer receivables are expected to be paid within one year and therefore the Company does not adjust for the effects of a financing component.

Contract liabilities are recorded when cash payments are received or due in advance of the Company's performance.

# HAMMOND MANUFACTURING COMPANY LIMITED

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c) Inventories:

Inventories are valued at the lower of cost, determined on a first-in, first-out basis and net realizable value, and include 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, costs include 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 that previously gave rise to an inventory write down no longer exist, the previous impairment is reversed.

d) 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 land held by Glen Ewing Property, at historical cost.

e) Property, plant and equipment:

Property, plant and equipment are shown in the statements of financial position at their historical cost. Costs include expenditures that are 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 or unit of production method so as to depreciate the initial cost down to the residual value over the estimated useful lives.

The depreciation rates based on the estimated useful lives for the current and comparative periods are as follows:

Asset	Rate
Buildings	2.5% - 5%
Office equipment	10% - 25%
Machinery and equipment	10% - 25%
Tooling general use	10% - 25%
Tooling specific part	Based on anticipated life output

Machinery and equipment under capital lease is initially recorded at the present value of minimum lease payments at the inception of the lease and amortized over the shorter of the lease term and their useful lives.

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

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f) Intangible assets other than goodwill:

Intangible assets have been externally acquired. Intangible assets are stated at cost less accumulated amortization. Intangible assets with a finite life are amortized using the straight-line method at rates calculated to amortize the cost of these assets over their estimated useful lives.

The amortization rates based on the estimated useful lives for the current and comparative periods are as follows:

Asset	Rate
Computer software	20%
Development costs	20%

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

g) Investments measured using equity method:

The Company uses the equity method as a basis of accounting for investments in companies over which it exercises significant influence or joint control. Under the equity method, the Company records these investments initially at cost and the carrying values are adjusted thereafter to include the Company's pro rata share of post-acquisition earnings of the investees, computed by the consolidation method. The adjustments are included in the determination of net income by the Company, and the investment accounts of the Company are also increased or decreased to reflect the Company's share of capital transactions (including amounts recognized in other comprehensive income). Profit distributions received from investees reduce the carrying values of the investments. Unrealized intercompany gains or losses are eliminated.

The Company's determination of significant influence is based on consideration of voting interest in the investees along with other indicators such as representation on the board of directors, participation in policy-making processes, material intercompany transactions, interchange of managerial personnel or provision of technical information. The Company uses the equity method to account for its 40% interest in RITEC.

h) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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i) 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 CGUs that are expected to benefit from the synergies of the business combination. Goodwill is tested for impairment at least annually and upon the occurrence of an indication of impairment.

j) Provisions:

Provisions may include liabilities of uncertain timing or amounts that arise from environmental, litigation, commercial or other risks. Provisions are recognized when a legal or constructive obligation exists stemming from a past event and when the future cash outflows can be reliably estimated. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the liability. Environmental provisions consider the present value of the anticipated clean-up costs.

k) Earnings per share:

Basic earnings per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings per share are computed similar to basic earnings per share 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 the proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period.

l) Financial assets and financial liabilities:

Financial assets are initially measured at fair value. On initial recognition, the Company classifies its financial assets at either amortized cost, fair value through other comprehensive income or fair value through profit or loss, depending on its business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. Financial assets are not reclassified subsequent to their initial recognition, unless the Company changes its business model for managing financial assets.

A financial asset is measured at amortized cost if it meets both of the following conditions: a) the asset is held within a business model whose objective is to hold assets to collect contractual cash flows and b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial liabilities are initially measured at fair value, net of transaction costs incurred. They are subsequently carried at amortized cost using the effective interest rate method; any difference between the proceeds (net of transaction costs) and the redemption value is recognized as an adjustment to interest expense over the period of the borrowings.

Financial liabilities include bank indebtedness, trade and other payables and long-term debt.

# HAMMOND MANUFACTURING COMPANY LIMITED

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m) Impairment:

i) Financial assets:

ECLs are recognized on all financial assets not carried at fair value through profit or loss. Expected credit losses are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive, discounted at an approximation of the original effective interest rate.

ECLs are recognized in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months. For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default.

For trade receivables and contract assets, the Company applies a simplified approach in calculating ECLs. Therefore, the Company does not track changes in credit risk, but instead recognizes a loss allowance based on lifetime ECL at each reporting date. The Company has established a provision matrix that is based on its historical credit loss experience, adjusted for forward looking factors specific to the debtors and the economic environment.

ii) Non-financial assets:

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

For the purposes of goodwill impairment testing, goodwill acquired in a business combination is allocated to the CGU, or the group of CGUs, that is expected to benefit from the synergies of the combination. The value in use is based on their future projected cash flows discounted to the present value at an appropriate pre-tax discount rate. Usually, 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 discount rate used approximates the Company's weighted average cost of capital. The business risk is included in the determination of the cash flows. Both the cash flows and the discount rates exclude inflation. An impairment loss in respect of goodwill is never subsequently reversed. The Group completed its annual impairment test at December 31, 2018 and December 31, 2017, and concluded there was no impairment.

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The Group's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset is allocated.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. Instead, the entire amount of the investment in an associate is tested for impairment as a single asset when there is objective evidence that the investment in an associate may be impaired.

n) Employee Benefits:

i) Defined contribution plans:

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 the periods during which services are rendered by the employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

ii) Other long-term employee benefits:

The Group's net obligation in respect of long-term employee benefits, other than pension plans, is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value and the fair value of any related assets is deducted. Any actuarial gains and losses are recognized in profit or loss in the period in which they arise.

iii) Termination benefits:

Termination benefits are recognized as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognized as an expense if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

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iv) Short-term employee benefits:

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.

v) Share-based payment transactions:

The grant date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in contributed surplus in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true up for differences between expected and actual outcomes. Share-based payment arrangements in which the Group receives goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group.

o) Segment reporting:

The continuing operations of the Company are in one operating segment, electrical and electronic components.

p) Finance costs:

Finance costs consist of interest on borrowings and finance leases.

q) Government Grants:

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants in respect of capital expenditures are credited to the carrying amount of the related asset and are released to income over the expected useful lives of the relevant assets. Government grants which are not associated with an asset are credited to income so as to net them against the expense to which they relate.

r) New standards and interpretations adopted:

The International Accounting Standards Board (IASB) has issued the following Standards, Interpretations and Amendments to Standards that were adopted by the Group.

**Classification and Measurement of Share-Based Payment Transactions (Amendment to IFRS 2):**

In June 2016, the IASB issued amendments to IFRS 2, *Share-Based Payments* clarifying how to account for certain types of share-based payment transactions. The amendments apply for

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annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early, application is permitted if information is available without the use of hindsight.

The amendments provide requirements on the accounting for:

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

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

## **IFRS 9 Financial instruments**

Effective January 1, 2018, the Company adopted IFRS 9 on a retrospective basis, which sets out requirements for recognition and measurement, impairment, derecognition of financial instruments and general hedge accounting. This standard simplifies the classification of a financial asset as either at amortized cost or at fair value as opposed to the multiple classifications which were permitted under IAS 39. This standard also requires the use of a single impairment method as opposed to the multiple methods in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The standard also adds guidance on the classification and measurement of financial liabilities.

Cash and trade and other receivables that were classified as loans and receivables under IAS 39 are classified as financial assets measured at amortized cost. There is no change to the initial measurement of the Company's financial assets. Impairment of financial assets is based on an expected credit loss ("ECL") model under IFRS 9, rather than the incurred loss model under IAS 39. ECLs are a probability weighted estimate of credit losses. The Company calculated ECLs based on consideration of customer specific factors and actual credit loss experience. As a percentage of revenue, the Company's actual credit loss experience has not been significant.

The adoption of IFRS 9 has not had an effect on the Company's accounting policies related to financial liabilities.

There was no material impact of transition to IFRS 9 on the Company's statement of financial position at January 1, 2018.

## **IFRS 15 Revenue from contracts with customers**

The Company has adopted IFRS 15 with a date of initial application of January 1, 2018. IFRS 15 includes a single, five-step revenue recognition model that requires entities to recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The standard also requires more informative, relevant disclosures.



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IFRS 15 supersedes IAS 11 “Construction Contracts” and IAS 18 “Revenue”, as well as various IFRIC and SIC interpretations regarding revenue. The Company has applied IFRS 15 using the cumulative effect method (without practical expedients) and therefore the comparative information has not been restated and continues to be reported under IAS 11 and IAS 18. The adoption of IFRS 15 did not result in a significant differences between the point of risk and rewards transfer for the sale of product under IAS 18, and the point of transfer of control under IFRS 15, therefore no transition adjustments were recognized as at January 1, 2018. As a result of the adoption of IFRS 15, the Company’s accounting policies have been updated, and additional disclosure has been included. See note 2 for these changes in accounting policies.

## **IAS 40 Transfer of Investment Property**

In December 2016, the IASB issued Amendments to IAS 40, *Transfers of Investment Property*.

The amendments clarify that:

- an entity shall transfer a property to, or from, investment property when, and only when, there is a change in use of a property supported by evidence that a change in use has occurred; and
- the list of circumstances of when a change in use has occurred is non-exhaustive.

The amendments apply for annual periods beginning on or after January 1, 2018.

The Group adopted the amendments to IAS 40 in its consolidated financial statements for the annual period beginning on January 1, 2018. There was no material impact on the consolidated financial statements.

## **Foreign Currency Transactions – Advance Consideration**

In December 2016, the IASB issued IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration* in response to diversity in practice in determining the appropriate exchange rate to use when translating assets, expenses or income, when foreign currency consideration is paid or received in advance of the item to which it relates.

The Interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date.

The Interpretation may be applied either:

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

The Interpretation is applicable for annual periods beginning on or after January 1, 2018.

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The Group adopted the Interpretation in its consolidated financial statements for the annual period beginning on January 1, 2018. There was no material impact from the adoption of this Interpretation on the consolidated financial statements.

s) New standards and interpretations not yet adopted:

The IASB 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.

## **IFRS 16 Leases**

In January 2016 the IASB issued IFRS 16, Leases. The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities from all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Group intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of this standard has yet to be determined.

## **Annual Improvements to IFRSs 2015-2017 Cycle**

On December 12, 2017 the IASB issued narrow-scope amendments to three standards as part of its annual improvements process.

Amendments were made to the following standards:

- IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements* - to clarify how a company accounts for increasing its interest in a joint operation that meets the definition of a business;
- IAS 12 *Income Taxes* – to clarify that all income tax consequences of dividends are recognized consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI, or equity; and
- IAS 23 *Borrowing Costs* – to clarify that specific borrowings – i.e. funds borrowed specifically to finance the construction of a qualifying asset should be transferred to the general borrowings pool once the construction of the qualifying asset has been completed.

The amendments are effective on or after January 1, 2019, with early application permitted. Each of the amendments has its own specific transition requirements.

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

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## IFRIC 23 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 in which there is uncertainty over income tax treatments.

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 predictions of the resolution;
- an entity to determine if it is probable that the tax authorities will accept the 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 Interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted.

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

## 4) Trade and other receivables:

	December 31, 2018	December 31, 2017
Trade receivables	\$ 18,095	\$ 15,485
Employee receivables	17	20
Other receivables	1,220	911
	19,332	16,416
Allowance for doubtful accounts	(278)	(155)
Trade and other receivables	\$ 19,054	\$ 16,261

The Company's exposure to credit and currency risks, and impairment losses related to trade and other receivables is disclosed in note 24.

## 5) Inventories:

	December 31, 2018	December 31, 2017
Raw materials and work-in-process	\$ 11,791	\$ 10,472
Finished goods	28,394	24,228
Inventories	\$ 40,185	\$ 34,700
Inventories carried at net realizable value	\$ 1,752	\$ 1,443

In 2018, raw materials, consumables and changes in finished goods and work in progress recognized as cost of sales amounted to approximately \$102,087,000 (2017 - \$89,357,000). In 2018, the write-down of inventories to net realizable value amounted to approximately \$89,000 (2017 - \$43,000). The write-down is included in cost of sales.

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## 6) Property, plant and equipment:

Cost	Land and	Machinery	Tooling	Office	Total
	buildings	and equipment		equipment	
Balance at December 31, 2016	\$ 20,130	\$ 43,278	\$ 9,757	\$ 5,111	\$ 78,276
Additions	\$ 491	\$ 2,957	\$ 511	\$ 139	\$ 4,098
Disposals	(3)	(1,068)	(507)	(106)	(1,684)
Effect of movements in exchange rates	1	(98)	(73)	(5)	(175)
Balance at December 31, 2017	\$ 20,619	\$ 45,069	\$ 9,688	\$ 5,139	\$ 80,515
Additions	\$ 1,557	\$ 6,979	\$ 677	\$ 462	\$ 9,675
Disposals	\$ (215)	\$ (954)	\$ -		(1,169)
Effect of movements in exchange rates	\$ 3	\$ 148	\$ 128	\$ 20	299
Balance at December 31, 2018	\$ 21,964	\$ 51,242	\$ 10,493	\$ 5,621	\$ 89,320

At December 31, 2018, the amount of expenditures recognized in the carrying amount that were in the course of construction is \$5,200 (2017 - \$nil) in land and buildings, \$536,909 (2017 - \$733,292) in machinery and equipment, \$70,213 (2017 - \$143,039) in tooling and \$nil (2017 - \$10,941) in office equipment.

### Accumulated depreciation

	Land and	Machinery	Tooling	Office	Total
	buildings	and equipment		equipment	
Balance at December 31, 2016	\$ 5,754	\$ 30,819	\$ 7,321	\$ 4,844	\$ 48,738
Depreciation for the year	\$ 525	\$ 1,965	\$ 353	\$ 112	\$ 2,955
Disposals	(2)	(1,068)	(488)	(106)	(1,664)
Effect of movements in exchange rates	1	(80)	(62)	(2)	(143)
Balance at December 31, 2017	\$ 6,278	\$ 31,636	\$ 7,124	\$ 4,848	\$ 49,886
Depreciation for the year	\$ 612	\$ 2,172	\$ 394	\$ 111	\$ 3,289
Disposals	(206)	(948)	-		(1,154)
Effect of movements in exchange rates	3	118	105	14	240
Balance at December 31, 2018	\$ 6,687	\$ 32,978	\$ 7,623	\$ 4,973	\$ 52,261

### Carrying amounts

	Land and	Machinery	Tooling	Office	Total
	buildings	and equipment		equipment	
At December 31, 2016	\$ 14,376	\$ 12,459	\$ 2,436	\$ 267	\$ 29,538
At December 31, 2017	\$ 14,341	\$ 13,433	\$ 2,564	\$ 291	\$ 30,629
At December 31, 2018	\$ 15,277	\$ 18,264	\$ 2,870	\$ 648	\$ 37,059

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Depreciation of \$3,289,000 (2017 - \$2,955,000) was recorded in the consolidated statement of comprehensive income (loss) as follows: cost of sales \$3,029,000 (2017 - \$2,694,000), selling and distribution \$181,000 (2017 - \$183,000) and general and administrative \$79,000 (2017 - \$78,000).

## 7) Intangible assets and goodwill:

### Cost

	Goodwill	Computer software	Development costs	Total
Balance at December 31, 2016	\$ 110	\$ 2,121	\$ 241	\$ 2,472
Additions	\$ -	\$ -	\$ -	\$ -
Effect of movement in exchange rates	2	(5)	-	(3)
Balance at December 31, 2017	\$ 112	\$ 2,116	\$ 241	\$ 2,469
Additions	\$ -	\$ 4	\$ 59	\$ 63
Effect of movement in exchange rates	4	7	-	11
Balance at December 31, 2018	\$ 116	\$ 2,127	\$ 300	\$ 2,543

### Amortization

	Goodwill	Computer software	Development costs	Total
Balance at December 31, 2016	\$ -	\$ 1,987	\$ 162	\$ 2,149
Amortization for the year	\$ -	\$ 28	\$ 28	\$ 56
Effect of movement in exchange rates	-	(5)	-	(5)
Balance at December 31, 2017	\$ -	\$ 2,010	\$ 190	\$ 2,200
Amortization for the year	\$ -	\$ 23	\$ 30	\$ 53
Effect of movement in exchange rates	-	6	-	6
Balance at December 31, 2018	\$ -	\$ 2,039	\$ 220	\$ 2,259

### Carrying amounts

	Goodwill	Computer software	Development costs	Total
At December 31, 2016	\$ 110	\$ 134	\$ 79	\$ 323
At December 31, 2017	\$ 112	\$ 106	\$ 51	\$ 269
At December 31, 2018	\$ 116	\$ 88	\$ 80	\$ 284

All the intangible assets have been externally acquired. All amortization expense have been recoded against cost of sales in the consolidated statement of comprehensive income (loss).

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Impairment testing for CGUs:

The Company has defined its CGUs as each individual legal entity, due to the fact that each location is largely independent of the other entities and each is ultimately responsible for sales generated in their markets. The Company monitors the performance of each legal entity through the use of profitability analysis based on the most recent business plan in place as at December 31, 2018.

Impairment testing for CGUs containing goodwill:

The Company performed an impairment test on the goodwill of its UK entity using the value in use method, under which a five year present value cash flow projection was completed using the Hammond Electronics Limited weighted average pre-tax cost of capital of 5.5%. The cash flow model also incorporated growth rates in the range of 3% – 5% based on the market location and the facility's operating history. This was then compared to the carrying value of the facility's assets, including goodwill, to determine if there was impairment. Effective December 31, 2018 and December 31, 2017, the assets, including goodwill of \$116,000 (2017 - \$112,000), of the Company's wholly owned subsidiary, Hammond Electronics Limited, were tested and no impairment was found.

## 8) Investment property:

The Group has a 50% ownership of a property in Georgetown, Ontario (referred to as the Glen Ewing Property). It is a vacant plot of land and currently under environmental remediation. The property value represents the actual historical cost of the property. Management has reviewed the property and local market conditions as well as the environmental condition of the property in estimating the property's fair value. Management estimates its interest in the property's fair market value to be approximately \$1,250,000. This estimate is unchanged from December 31, 2017. No independent valuation has been performed. The property is currently vacant and no income is being derived from it. The Company's direct operating expense in 2018 related to the property was \$89,000 (2017 - recovery of \$50,000).

## 9) Equity investment:

RITEC Enclosures Inc.	
	Total
December 31, 2016	\$ 638
Equity in 2017 earnings	116
December 31, 2017	\$ 754
Equity in 2018 earnings	43
December 31, 2018	\$ 797

Since 2008, the Company has had 40% ownership of RITEC. All dividends paid since taking the 40% holding in 2008 have been reinvested in RITEC.

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RITEC Enclosures Inc.		
For the years ended December 31,	2018	2017
Share of profit	\$ 2	\$ 43
Foreign exchange gain (loss)	41	80
Income tax expense	-	(7)
Equity investment earnings	\$ 43	\$ 116
Share of profit	\$ 2	\$ 43
Profit in inventory movement	(38)	35
Share of profit of equity accounted investees	\$ (36)	\$ 78

RITEC Enclosures Inc.		
	December 31, 2018	December 31, 2017
Assets	\$ 3,148	\$ 2,931
Liabilities	1,756	1,617
Revenues	3,269	3,457
Profit (after tax)	108	290

## 10) Loans and borrowings:

Bank indebtedness:

Bank indebtedness is due on demand and secured by inventories, a general assignment of trade receivables and a charge on specific assets of the Company. The Company has established operating lines for the entities in Canada, the US and the UK. The following chart depicts the amount utilized on each of the entities' lines of credit.

		December 31, 2018		December 31, 2017	
		Local currency	CAD	Local currency	CAD
Canadian entities	CAD	\$ 7,243	\$ 7,243	\$ 5,351	\$ 5,351
UK entity	GBP	£ 204	356	£ 215	365
Bank indebtedness			\$ 7,599		\$ 5,716

Interest was payable at the rate of bank prime plus 50 basis points through August of 2018 and subsequently at the rate of bank prime plus 25 basis points (2017 - bank prime plus 50 basis points).

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## Long-term debt:

	December 31, 2018	December 31, 2017
Demand term loan drawn in USD funds at a fixed interest rate of 6.05% through December 2018, secured by the assets of HMCL. Monthly principal installments of \$15 USD.	\$ -	\$ 230
Demand term loan amortized over 25 years drawn in USD funds at a fixed interest rate of 5.30% through March 2026, secured by the assets of HMCL. Monthly blended installments of \$9 USD.	1,963	1,845
Demand term loan amortized over 25 years drawn in CAD funds at a fixed interest rate of 5.20% through March 2026, secured by the assets of HMCL. Monthly blended installments of \$9 CAD.	1,438	1,470
Demand term loan amortized over 25 years drawn in CAD funds at a fixed interest rate of 4.1% through December 2023, secured by the assets of HMCL. Monthly blended installments of \$37 CAD.	6,560	6,728
Demand term loan amortized over 7 years drawn in CAD funds at a fixed interest rate of 4.43% through December 2025, secured by the assets of HMCL. Monthly blended installments of \$70 CAD.	4,988	-
Demand term loan amortized over 7 years drawn in CAD funds at a fixed interest rate of 4.0% through December 2025, secured by the assets of HMCL. Monthly blended installments of \$26 CAD.	1,925	-
Interest free term loan of \$385 CAD made in 2015, \$1,150 CAD in 2016, \$958 CAD in 2017 and \$624 CAD in 2018 through the Federal Economic Development Agency for Southern Ontario. Repayment will be over 60 equal monthly installments starting January 1, 2020. Value represents the present value of the stream of payments to repay utilizing a 5.2% discount factor.	2,600	1,975
<b>Subtotal</b>	<b>19,474</b>	<b>12,248</b>
Finance lease obligations:		
Secured by equipment, drawn in GBP sterling at interest rate 8.8%. Monthly installments of £1 GBP until April 2019.	8	31
Secured by equipment, drawn in GBP sterling at interest rate 4.85%. Monthly installments of £1.46 GBP until October 2020.	53	79
Secured by equipment, drawn in GBP sterling at interest rate 5.3%. Monthly installments of £1.6 GBP until February 2022.	100	-
Secured by equipment, drawn in USD funds at interest rate of 4.97%. Monthly installments of \$7 USD until April 2019 with a lump sum payment at that time of \$114 USD.	190	267
Secured by equipment, drawn in USD funds at interest rate of 3.75%. Monthly installments of \$57 USD until May 2023.	3,773	4,193
Secured by equipment, drawn in USD funds at interest rate of 3.5%. Monthly installments of \$0.42 USD until December 2020.	13	18
<b>Subtotal</b>	<b>4,137</b>	<b>4,588</b>
<b>Total long-term debt</b>	<b>\$ 23,611</b>	<b>\$ 16,836</b>
Less current portion of long-term debt	17,955	11,040
<b>Non-current long-term debt</b>	<b>\$ 5,656</b>	<b>\$ 5,796</b>



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The aggregate amount of principal payments required to meet the existing long-term debt obligations in each of the next five years is as follows:

2019	\$	17,955
2020		1,484
2021		1,460
2022		1,438
2023		805
Thereafter		469
	\$	23,611

The following reflects the aggregate amount of principal payments required to meet the existing long-term debt obligations in each of the next five years is if the loans are not placed on demand:

2019	\$	2,216
2020		2,670
2021		2,699
2022		2,733
2023		7,764
Thereafter		5,529
	\$	23,611

Interest expense is comprised as follows:

	December 31, 2018	December 31, 2017
Long-term debt, including capital leases	\$ 895	\$ 670
Bank indebtedness	519	330
Interest expense	\$ 1,414	\$ 1,000

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

	Long-term debt	Bank indebtedness
Balance at January 1, 2018	\$ 16,836	\$ 5,716
<b>Changes from financing cash flows</b>		
Proceeds from loans and borrowings	7,764	1,875
Repayment of borrowings	(1,336)	-
Total changes from financing cash flows	6,428	1,875
<b>Liability related</b>		
Interest expense	895	519
Interest paid	(781)	(519)
Impact of interest free term loan	(121)	-
Total liability-related other changes	(7)	-
Foreign exchange impact	354	8
Balance at December 31, 2018	\$ 23,611	\$ 7,599

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## 11) Trade and other payables:

	December 31, 2018	December 31, 2017
Trade payables	\$ 4,902	\$ 4,911
Non-trade payables and accrued expenses	10,826	9,170
	\$ 15,728	\$ 14,081

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 24.

## 12) Provisions:

	Environmental remediation	Sales returns	Total
Balance at December 31, 2016	\$ 170	\$ 55	\$ 225
Provisions made during the year	-	39	39
Provisions used during the year	-	(49)	(49)
Balance at December 31, 2017	\$ 170	\$ 45	\$ 215
Provisions made during the year	-	45	45
Provisions used during the year	-	(36)	(36)
Balance at December 31, 2018	\$ 170	\$ 54	\$ 224
Non-current	100	-	100
Current	70	54	124
Balance at December 31, 2018	\$ 170	\$ 54	\$ 224

The provision for environmental remediation is based on the estimated costs to setup and extract contamination from the Glen Ewing Property. The anticipated costs are based on an external consultant's remediation plan, discounted for expected timing of expenditures. There are approximately three years remaining in the clean-up plan. The Glen Ewing Property is owned equally as a co-tenant with Hammond Power Solutions Incorporated and any expenses or liabilities in respect of the property have been agreed to be shared equally. The contamination did not result from the normal operations of the Company. The parties have cooperatively developed a remediation action plan and began remediation in October 2009. The Ministry of Environment is aware of the remediation and the process being used. New extraction wells scheduled for 2015 were deferred for three years which in turn has pushed the remediation plan out three years. The Company is satisfied that their consultants have provided the best estimate available for the Company's remaining portion of the environmental remediation costs for this site of \$170,000 (2017 - \$170,000) with \$70,000 (2017 - \$70,000) presented as a current provision.

The provision for sales returns is based on estimates from historical returns of product. The provision reflects the estimated profit margin of the anticipated returns.

## 13) Employee future benefits:

The Company's net obligation in respect of its current and long-term employee benefits is calculated by estimating the amount of future benefit that employees have earned in return for their service in

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the current and prior periods. The terms of the agreements do not require the Company to fund these obligations as they accumulate. The Company has accounted for these post-employment benefits as defined benefit plans. The benefit plans are broken into two categories:

a) Benefit for post-employment health benefits:

If an employee meets the set criteria and retires between the age of 60 and 65, their health plan will continue until age 65. This program was closed in 2014 and the obligation reflects the anticipated cost for those employees who exercised this option prior to closing.

b) Disability health coverage:

This benefit is for employees who are off work due to a covered disability. Health coverage will continue until they are off disability or reach the age of 65, whichever occurs first.

In determining both the post-employment health benefit and the disability health coverage liabilities a 3.5% (2017 – 3.5%) per annum health cost increase and a discount rate of 6.0% (2017 – 6.0%) were utilized to determine its present value.

Assumed healthcare cost trend rates affect the amounts recognized in profit and loss. A 1% change in assumed healthcare cost trend rates would increase (decrease) the aggregate service and interest costs by \$19,000 (2017 - \$20,000). Changes in assumptions resulted in nominal gains/losses which have been included in general and administrative expense.

	December 31, 2018	December 31, 2017	
Post employment health benefits	\$ 23	\$ 20	
Employee health benefits while on disability	257	270	
<b>Total employee future benefits</b>	<b>\$ 280</b>	<b>\$ 290</b>	
	Post employment health benefits	Employee health benefits while on disability	Total
Balance at December 31, 2016	\$ 27	\$ 281	\$ 308
Provisions made during the year	-	46	46
Provisions used during the year	(7)	(57)	(64)
Balance at December 31, 2017	\$ 20	\$ 270	\$ 290
Provisions made during the period	9	50	59
Provisions used during the period	(6)	(63)	(69)
Balance at December 31, 2018	\$ 23	\$ 257	\$ 280
Non-current	15	194	209
Current	8	63	71
Balance at December 31, 2018	\$ 23	\$ 257	\$ 280

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## 14) Deferred tax assets and liabilities:

Unrecognized deferred tax liabilities:

At December 31, 2018, temporary differences of \$19,900,000 (2017 - \$16,598,000) 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.

Recognized deferred tax liabilities:

Deferred tax assets and liabilities are attributable to the following:

	December 31, 2018	December 31, 2017
<b>Deferred tax assets</b>		
Intangible assets	\$ -	\$ 25
Investment property	8	8
Inventories	391	426
Loans and borrowings	995	1,104
Provisions	95	96
Total deferred tax assets	1,489	1,659
<b>Deferred tax liabilities</b>		
Property, plant and equipment	(3,459)	(2,935)
Total deferred tax liabilities	(3,459)	(2,935)
Net tax liabilities	\$ (1,970)	\$ (1,276)

## 15) Share capital:

a) Authorized:

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, no par value. Annual dividends on the Class B common shares may not exceed the annual dividends on the Class A subordinate voting shares.

Unlimited number of Class YA non-voting, no par value, redeemable, retractable shares entitled to non-cumulative discretionary dividends. No dividends shall be declared or paid on the Class YA shares unless the same dividend is simultaneously declared and paid on the Class YB shares.

Unlimited number of Class YB non-voting, no par value, redeemable, retractable shares entitled to non-cumulative discretionary dividends. No dividends shall be declared or paid on the Class YB shares unless the same dividend is simultaneously declared and paid on the Class YA shares.

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b) Issued:

	December 31, 2018	December 31, 2017
8,556,000 Class A shares (2017 - 8,556,000)	\$ 10,242	\$ 10,242
2,778,300 Class B shares (2017 - 2,778,300)	7	7
	\$ 10,249	\$ 10,249

No shares were issued in 2018 or in 2017.

c) Dividends:

The following dividends were declared and paid by the Company:

Special cash dividends of \$0.04 per Class A subordinate voting share were declared and paid in 2018 (2017 – \$0.02) and special cash dividends of \$0.04 per Class B common share were declared and paid in 2018 (2017 – \$0.02).

Total dividends declared and paid in 2018 were \$452,000 (2017 - \$226,000).

## 16) Operating leases:

The Company is committed to payments under operating leases for equipment and buildings. The future minimum non-cancellable operating lease rentals are payable as follows:

	December 31, 2018	December 31, 2017
Less than 1 year	\$ 2,326	\$ 2,046
Between 1 and 5 years	4,852	4,597
Thereafter	1,356	1,773
Total minimum payments	\$ 8,534	\$ 8,416

The Group leases a number of office, warehouse and factory facilities under operating leases. The leases typically run for a period of three to five years, with an option to renew the lease after that date. The Group does have one warehouse lease that runs to 2027.

During the year ended December 31, 2018, an amount of \$2,487,000 was recognized as an expense in profit or loss in respect of operating leases (2017 - \$2,032,000).

The warehouse and factory leases have been renewed over several terms as combined leases of land and buildings. Since the land title does not pass, the rent paid to the landlord of the building is increased to market rent at regular intervals, and the Company does not participate in the residual value of the building, it was determined that substantially all the risks and rewards of the building are with the landlord. As such, the Company determined that the leases are operating leases.

## 17) Commitments:

The Company has contractual obligations for outstanding capital expenditures of \$519,000 (2017 - \$4,609,000). These expenditures should be completed in the first half of 2019.

## 18) Contingency:

A statement of claim was issued on June 19, 2013, against HMCL with respect to a property once held by the Company. The claim alleges that contaminants originating from the property once owned by HMCL have migrated to a nearby, but not adjoining property owned by the claimants. The amount of the claim is not fully known but includes \$3,500,000 which is the estimated cost of construction of a barrier and related expenses. At this point in time, there is no certainty that the contaminants

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emanated from the property once owned by HMCL. In 2017, the claim moved into the discovery proceedings level. There have been no significant developments to this claim otherwise. Given the nature of the claim, there remains significant uncertainty as to any costs to be incurred as a result of the claim and accordingly management is unable to reasonably estimate any liability that may arise as a result of this claim. As such, no amount has been recorded in these consolidated financial statements.

## 19) Income tax expense:

	December 31, 2018		December 31, 2017	
Current tax expense	\$	593	\$	1,450
Deferred tax expense:				
Origination and reversal of temporary differences		685		377
<b>Total income tax expense</b>	<b>\$</b>	<b>1,288</b>	<b>\$</b>	<b>1,827</b>

	2018		2017	
Net income for the year	\$	3,764	\$	4,560
Total income tax expense		1,288		1,827
Income before income tax	\$	5,052	\$	6,387
Income tax using the Company's domestic tax rate	38.00%	1,920	38.00%	2,427
Reduced rate for active business and manufacturing and processing	(7.22%)	(365)	(8.02%)	(512)
Effect of tax rates in foreign jurisdictions	(6.59%)	(333)	(2.27%)	(145)
Reduction in tax rate	0.00%	-	0.08%	5
Non-deductible expenses	0.57%	29	0.22%	14
Other	0.73%	37	0.59%	38
	<b>25.49%</b>	<b>\$ 1,288</b>	<b>28.61%</b>	<b>\$ 1,827</b>

## 20) Earnings per share:

The computations for basic and diluted earnings per share are as follows:

	December 31, 2018		December 31, 2017	
Net income for the year	\$	3,764	\$	4,560
Average number of common shares outstanding:				
Basic and Diluted		11,334,300		11,334,300
Earnings per share:				
Basic	\$	0.33	\$	0.40
Diluted		0.33		0.40

No share options to purchase common shares were outstanding as at December 31, 2018 or December 31, 2017.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

## 21) Personnel expenses:

	2018	2017
Wages and salaries	\$ 44,912	\$ 38,777
Health benefit plans	4,908	4,515
Canada Pension Plan and Employment Insurance	2,536	2,108
Contributions to defined contribution plans	1,349	1,157
	\$ 53,705	\$ 46,557

	2018	2017
Cost of sales	\$ 40,421	\$ 34,085
Selling and distribution	10,115	9,379
General and administrative	2,938	2,912
Research and development	231	181
	\$ 53,705	\$ 46,557

## 22) Management share option plan:

As at December 31, 2018, the Company has a stock-based compensation plan, which is described below. No options were granted through December 31, 2018 or in 2017 and no stock options were outstanding as of January 1, 2017, and, accordingly, no stock-based compensation expense has been incurred in either year.

In 1986, the Company established the management share option plan providing for the granting to directors, officers and key employees of the Company options to purchase the Class A subordinate voting shares of the Company. A maximum number of 540,000 Class A subordinate voting shares are issuable under the plan. The exercise price for purchasing Class A subordinate voting shares may not be less than the market price of the Class A subordinate voting shares at the date the option is granted.

## 23) Determination of fair values:

The carrying values of the Group's financial assets and liabilities, consisting of cash, trade and other accounts receivables, bank indebtedness, trade and other accounts payables approximate their fair values due to the relatively short periods to maturity of the instruments.

The market values of financial assets and liabilities together with the carrying amounts shown in the statements of financial position are as follows:

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

	December 31, 2018		December 31, 2017	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Assets carried at amortized cost</b>				
Cash	\$ 625	\$ 625	\$ 1,051	\$ 1,051
Trade and other receivables	19,054	19,054	16,261	16,261
	<b>\$ 19,679</b>	<b>\$ 19,679</b>	<b>\$ 17,312</b>	<b>\$ 17,312</b>
<b>Liabilities carried at amortized cost</b>				
Bank indebtedness	\$ 7,599	\$ 7,599	\$ 5,716	\$ 5,716
Trade and other payables	15,728	15,728	14,081	14,081
Term loans	19,474	18,892	12,248	11,804
Finance lease obligations	4,137	4,025	4,588	4,434
	<b>\$ 46,938</b>	<b>\$ 46,244</b>	<b>\$ 36,633</b>	<b>\$ 36,035</b>

Interest rates used to discount estimated cash flows, when applicable, are based on bank indication rates for similar type arrangements.

Bank indication interest rates	December 31, 2018		December 31, 2017	
	From	To	From	To
Nonsecured variable interest rates	4.0%	5.0%	3.2%	4.2%
<b>Fixed rates</b>				
1 to 2 year secured	4.5%	5.6%	4.3%	5.3%
3 to 4 year secured	4.6%	5.7%	4.6%	5.6%
5 year secured	4.7%	5.7%	4.7%	5.7%
7 year secured	4.9%	5.9%	4.9%	5.9%
10 year secured	5.1%	6.1%	5.1%	6.1%

Rates fluctuate depending on currency and jurisdiction.

## 24) Financial instruments and risk management:

### Overview

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk
- foreign currency risk
- interest rate risk
- operational risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.



# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

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## Risk management framework:

The Board of Directors has overall responsibility for the oversight of the Group's risk management framework. The Board is responsible for monitoring the Group's risk management policies.

The Group's risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by the corporate finance group. The corporate finance group undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

## Credit risk:

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers. The carrying amount of financial assets represents the maximum credit risk exposure.

## Trade and other receivables:

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on credit risk.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group's review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer, which represents the maximum open amount without requiring approval from management. Customers that fail to meet the Group's benchmark creditworthiness may transact with the Group only on a prepayment basis.

In monitoring customer credit risk, customers are grouped according to their credit characteristics, including whether they are an individual or legal entity, whether they are a wholesale, retail or end-user customer, geographic location, industry, aging profile, maturity and existence of previous financial difficulties. Trade and other receivables relate mainly to the Group's wholesale customers. Customers that are graded as "high risk" are placed on a restricted customer list and monitored by the accounts receivable department, and future sales are made on a prepayment basis.

The Group does not require collateral in respect of trade and other receivables.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

The Group establishes an allowance for doubtful accounts that represents its estimate of expected credit losses that could arise from the failure or inability of customers to make payments when due. This allowance is determined based on historical data of payment statistics for similar financial assets and historical credit losses, adjusted for forward looking factors, specific to the debtor and the economic environment.

The Company is exposed to financial risk that arises from the credit quality of the entities to which it sells products and services. The Company sells to a variety of companies in a number of different industries and geographic areas. As a result, the requirement for an industry specific or geographic reserve is minimal.

The carrying amount of financial assets represents the maximum credit exposure which was as follows at the reporting date:

	December 31, 2018	December 31, 2017
Cash and receivables:		
Cash	\$ 625	\$ 1,051
Trade and other receivables	19,054	16,261
	<u>\$ 19,679</u>	<u>\$ 17,312</u>

The maximum exposure to credit risk for cash and receivables at the reporting date by geographic region was:

	December 31, 2018	December 31, 2017
Cash and receivables:		
Canada	\$ 10,727	\$ 9,327
US	7,652	6,818
UK	1,190	1,082
Australia	110	85
	<u>\$ 19,679</u>	<u>\$ 17,312</u>

The following table reflects the net details of trade receivables as at December 31, 2018 and December 31, 2017:

	December 31, 2018			December 31, 2017		
	Gross	Impairment	Carrying value	Gross	Impairment	Carrying value
Aging of trade receivables:						
1 – 30 days	\$ 8,764	\$ -	\$ 8,764	\$ 8,685	\$ -	\$ 8,685
31 – 60 days	7,245	-	7,245	5,151	-	5,151
61 – 90 days	1,733	-	1,733	1,363	-	1,363
Over 90 days	353	278	75	286	155	131
Trade receivables	<u>\$ 18,095</u>	<u>\$ 278</u>	<u>\$ 17,817</u>	<u>\$ 15,485</u>	<u>\$ 155</u>	<u>\$ 15,330</u>

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

The following table provides the roll forward of the allowance for doubtful accounts:

	December 31, 2018	December 31, 2017
Allowance for doubtful accounts, beginning of year	\$ 155	\$ 150
Accounts provided for in the period	131	5
Amounts written off during the period	(8)	-
Allowance for doubtful accounts	\$ 278	\$ 155
Allowance for doubtful accounts as % of net trade receivable	1.5%	1.0%

The following table provides the net details of trade and other receivables:

	December 31, 2018	December 31, 2017
Net trade receivable	\$ 17,817	\$ 15,330
Employee receivables	17	20
Other receivable	1,220	911
Trade and other receivables	\$ 19,054	\$ 16,261

Liquidity risk:

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group uses planning tools to identify future cash flow requirements.

The Group has established a \$15,500,000 overdraft facility that is secured against inventory and accounts receivable. If drawn upon, interest would be payable at the rate of bank prime plus 25 basis points (2017 - bank prime plus 50 basis points). The Company had available unused credit facilities in the amount of \$7,901,000 at December 31, 2018 (2017 - \$9,784,000) to meet fluctuations in working capital requirements.

The Group has established an \$13,500,000 (2017 - \$11,000,000) lease line to finance new equipment purchases of which it has utilized \$12,252,000 (2017 - \$5,236,000).

In 2015, the Group successfully applied for and was approved by the Federal Economic Development Agency for Southern Ontario for an interest free loan up to \$3,461,500 on eligible spending. As at December 31, 2018, the group had received \$3,115,000 of this funding (2017 - \$2,493,000). The present value of this funding \$2,354,000 was set up as long term debt and \$761,000 which reflects the interest savings has been offset to property, plant and equipment.

In 2015, the Group successfully applied for and was approved by the Southwestern Ontario Development Fund for a grant up to \$1,500,000 on eligible spending. As at December 31, 2018, the Group had received \$989,000 (2017 - \$724,000) of this funding and has a receivable for an additional \$511,000 based on the eligible spending to date. The \$1,500,000 has been offset to property, plant and equipment.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

The interest free loan and grant noted above are contingent on adding new jobs and retaining existing jobs at its Guelph, Ontario locations. As at December 31, 2018, the Group was in compliance with this requirement.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting arrangements. It is not expected that the cash flows included in the maturity analysis will occur significantly earlier or at materially different amounts.

December 31, 2018						
	Carrying amount	Contractual cash flows	2019	2020	2021 to 2022	Thereafter
Non-derivative financial liabilities						
Term loans	\$ 19,474	\$ (19,989)	\$(16,874)	\$ (623)	\$ (1,246)	\$ (1,246)
Finance lease obligations	4,137	(4,473)	(1,218)	(1,011)	(1,929)	(315)
Trade and other payables	15,728	(15,728)	(15,728)	-	-	-
Bank indebtedness	7,599	(7,599)	(7,599)	-	-	-
<b>Total</b>	<b>\$ 46,938</b>	<b>\$ (47,789)</b>	<b>\$(41,419)</b>	<b>\$ (1,634)</b>	<b>\$ (3,175)</b>	<b>\$ (1,561)</b>
December 31, 2017						
	Carrying amount	Contractual cash flows	2018	2019	2020 to 2021	Thereafter
Non-derivative financial liabilities						
Term loans	\$ 12,248	\$ (12,766)	\$(10,273)	\$ -	\$ (997)	\$ (1,496)
Finance lease obligations	4,588	(5,052)	(1,034)	(1,091)	(1,769)	(1,158)
Trade and other payables	14,081	(14,081)	(14,081)	-	-	-
Bank indebtedness	5,716	(5,716)	(5,716)	-	-	-
<b>Total</b>	<b>\$ 36,633</b>	<b>\$ (37,615)</b>	<b>\$(31,104)</b>	<b>\$ (1,091)</b>	<b>\$ (2,766)</b>	<b>\$ (2,654)</b>

## Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

## Foreign currency risk:

The Group has a substantial number of transactions denominated in US dollars and is exposed to risk with respect to fluctuations in exchange rates between Canadian and US dollars. The Group holds smaller positions in other foreign currencies. The Group does not use derivative instruments to reduce its exposure to foreign currency risk. As a result, variations in foreign exchange rates could cause unanticipated fluctuations in the Group's operating results.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

The following chart depicts the foreign currency positions.

Currency		Accounts receivable		Accounts payable		Long-term debt	
		Dec 31, 2018	Dec 31, 2017	Dec 31, 2018	Dec 31, 2017	Dec 31, 2018	Dec 31, 2017
Australia	AUD	40	30	(3)	(14)	-	-
Europe	EURO	33	203	(33)	(22)	-	-
New Zealand	NZD	78	52	-	-	-	-
Taiwan	TWD	182	499	(198)	-	-	-
UK	GBP	748	473	(405)	(232)	(92)	(65)
US	USD	5,523	5,281	(1,937)	(2,451)	(4,354)	(5,223)

Long-term debt includes loans and capital leases denominated in foreign currencies which may affect the amount of principal and interest payments ultimately recorded.

#### Sensitivity Analysis:

An average one-cent decrease of the Canadian dollar against the US dollar in 2018 would have increased net product sales by \$629,000 (2017 - \$552,000) and increased income from operations by \$679,000 (2017 - \$594,000). Inversely, a one cent increase in the Canadian dollar against the US dollar in 2018 would have had the equal but opposite effect. This analysis assumes that all other variables remain constant. As noted, the Company does deal in other currencies but the level of impact of these currencies would not be significant.

#### Interest rate risk:

Interest rate risk arises from the possibility that the cash flows related to a financial instrument would fluctuate as a result of changes in market interest rates. The Group is exposed to financial risk that arises from the interest rate differentials between the market interest rate and the rates on its cash, bank indebtedness, and its float rate term loans. Changes in variable interest rates could cause unanticipated fluctuations in the Group's operating results.

#### Sensitivity Analysis:

A one percent increase in the variable rates charged on ending 2018 bank indebtedness would increase annual interest expense by \$76,000 (2017 - \$57,000). This analysis assumes that all other variables remain constant. Inversely, a one percent decrease in the variable rates charged on ending 2018 bank indebtedness would have had the equal but opposite effect.

#### Operational risk:

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, liquidity and market risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

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The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance when this is effective.

Compliance with Group standards is supported by a program of periodic reviews undertaken by the corporate finance group. The results of the reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Group.

Capital management:

In order to manage capital, the Group regularly identifies and assesses risks that threaten the ability to meet the Company's capital management objectives, and determines the appropriate strategy to mitigate these risks.

The Group's objectives when managing capital are to:

- maintain financial flexibility in order to preserve its ability to meet financial obligations
- deploy capital to provide an appropriate investment return to its shareholders
- maintain capital structure that allows multiple financing options to the Group should a financing need arise.

The Group defines its capital as follows:

- shareholders' equity
- long-term debt, including the current portion
- cash and cash equivalents and short-term borrowings

The Group is subject to externally imposed capital requirements through the covenants of its facility arrangements with the bank. The covenants measure Debt to Total Net Worth, Debt Service Ratio and Current Ratio. The Group is in compliance with its covenants at December 31, 2018 and has been in compliance with its covenants through 2017 and 2018. There were no changes to the Group's approach to capital management during 2018. Neither the Company, nor any of its subsidiaries, is subject to externally imposed capital requirements.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

## 25) Segment disclosures:

The continuing operations of the Company are in one operating segment, electrical and electronic components.

The Company and its subsidiaries operate in Canada, the US, the UK and Australia.

Geographic segments	Year ended:	
	December 31, 2018	December 31, 2017
Net product sales:		
Canada:		
Sales to customers	\$ 55,434	\$ 47,811
US:		
Sales to customers	77,160	67,737
All other countries:		
Sales to customers	13,008	11,858
Net product sales	\$ 145,602	\$ 127,406
Non-current assets:		
Canada:		
Non-current assets	\$ 37,425	\$ 31,619
US:		
Non-current assets	1,128	541
All other countries:		
Non-current assets	631	536
Total Non-current assets	\$ 39,184	\$ 32,696

## 26) Related party transactions:

- a) Key management includes the Company's directors and members of the executive management team. Compensation awarded to key management included:

	Years ended:	
	December 31, 2018	December 31, 2017
Salaries and short-term employee benefits	\$ 716	\$ 696

- b) The Company purchased \$3,870,000 of product from RITEC in 2018 (2017 - \$2,601,000). The Company sold \$13,990 of product to RITEC in 2018 (2017 - \$27,533). These transactions were made in the normal course of business and have been recorded at the exchange amounts, being the amount agreed to by the two parties.

All outstanding trade balances with related parties are to be settled in cash within six months of the reporting date. None of the balances are secured. Receivables as at December 31, 2018 were \$8,111 (2017 - \$21,200) while payables were \$8,840 (2017 - \$nil). Trade receivables and payables to related parties are included within trade and other receivables and trade and other payables on the Consolidated Statement of Financial Position.

- c) The Chairman of the Corporation, Robert Frederick Hammond, through direct and indirect ownership of Class A and Class B voting shares effectively controls the Company.

# HAMMOND MANUFACTURING COMPANY LIMITED

Notes to Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(tabular amounts (except share amounts) in thousands of Canadian dollars)

Consolidated entities:

<b>HAMMOND MANUFACTURING COMPANY LIMITED</b>			
	Country of incorporation	% Ownership interest	
		December 31, 2018	December 31, 2017
Les Fabrications Hammond (Quebec) Inc. / Hammond Manufacturing (Quebec) Inc.	Canada	100	100
Hammond Electronics Pty Limited	Australia	100	100
Hammond Electronics Limited	UK	100	100
Subsidiary of above: Hammond Electronics Asia Limited	Taiwan	100	100
Hammond Manufacturing Company Inc.	US	100	100
Subsidiaries of above: Hammond Holdings Inc.	US	100	100
Paulding Electrical Products, Inc	US	100	100

The year end for each of the entities listed in the table above is December 31.



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# Through the Years



Hammond Rack and Cabinet Division celebrates 85 years.

2019

**85 YEARS** MANUFACTURING RACKS & CABINETS SINCE 1934



2017

Hammond Celebrates 100 Years in Business



Guelph Operations Expands with an additional state-of-the-art Manufacturing Facility.

2016

Dry-Type Transformer Business split off under new company, Hammond Power Solutions. Shares of Hammond power solutions distributed as a separate public company



2000

Hammond goes Public on Toronto Stock Exchange



1986

Hammond expands to the UK opening in Basingstoke



1980's

Hammond Manufacturing re-branded to current identify



1976



New Factory built on Speedvale/Edinburgh Road



1955

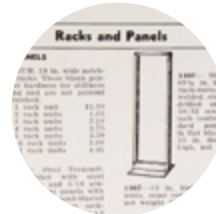
**HAMMOND**

Added NEMA Enclosures



1950

Transition into manufacture of Transformers, Wire Wound Resistors and Broadcast Racks/Cabinets



1930

*Hammond*

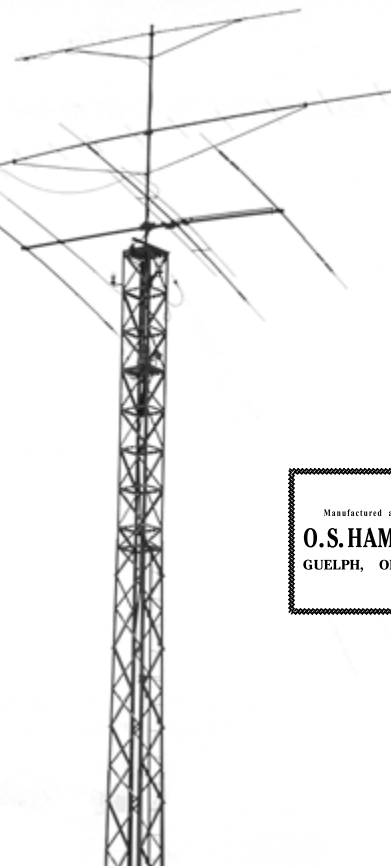
Hammond O.S. & Son - built radios, amplifiers, and battery eliminators

1927

Manufactured and Fully Guaranteed by  
**O.S. HAMMOND & SON**  
GUELPH, ONTARIO, CANADA

Backyard Workshop - Charging batteries, installing antennas, custom machining

1917





## Corporate Directory

1-877-535-3282 (Canada) | 1-800-526-2266 (USA) | [www.hammondmfg.com](http://www.hammondmfg.com) | [@hammondmfg](https://twitter.com/hammondmfg)

### Directors

**Robert F. Hammond**  
Chairman and CEO

**\*Edward Sehl**  
Principal - Sehl Consulting  
Director Of Guelph General Hospital

**\*Paul Quigley**  
President - Quigley Group Inc.

**Sheila Hammond B.A., B.Ed., M.Sc.**  
Registered Marriage & Family Therapist  
Officer & Director, Eramosa Group Ltd.

**\*Michael Fricker**  
CFO of Qvella Corporation and Reunion Foods Inc.

**\*William Wiener**  
Chairman of the Board of Viscor Inc.  
Chairman of the Board of 35 Oak Holdings Ltd.

**Sarah Hansen**  
Operations Manager of Emco Corporation in Calgary  
Director of Eramosa Group Ltd.  
Director of DKH Engineering Services Inc.

### Officers / Senior Management

**Robert F. Hammond**  
Chairman and CEO

**Alexander Stirling**  
Secretary and CFO

**Ray Shatzel**  
Vice-President, Electronic Sales

**Ross N. Hammond**  
Assistant Secretary

### Auditors

**KPMG LLP**  
RSM, UK  
ASF Audits, Australia

### Legal Counsel

**Borden Ladner Gervais**

### Transfer Agent and Registrar

**Computershare Investor Services Inc.**

### Stock Listing

Toronto Stock Exchange  
Symbol: HMM.A

### Bankers

**HSBC**

\*Members of the Audit Committee and Compensation Committee

### Head Office

Hammond  
Manufacturing  
394 Edinburgh Rd N,  
Guelph, ON, N1H 1E5  
P. (519) 822 2960  
F. (519) 822 0715  
[ir@hammfg.com](mailto:ir@hammfg.com)

### Québec

Les Fabrications  
Hammond  
(Québec) Inc.  
985 Rue Bergar,  
Laval, QC, H7L 4Z6  
P. (450) 975 1884  
F. (450) 975 2098  
[sales@hammfg.com](mailto:sales@hammfg.com)

### USA

Hammond  
Manufacturing  
Company Inc.  
475 Cayuga Rd,  
Cheektowaga, NY  
14225  
P. (716) 630 7030  
F. (716) 630 7042  
[sales@hammfg.com](mailto:sales@hammfg.com)

### Australia

Hammond  
Electronics Pty. Ltd.  
11-13 Port Rd,  
Queenstown  
SA 5014  
P. +61 8 8240 2244  
F. +61 8 8240 2255  
[australia@hammfg.com](mailto:australia@hammfg.com)

### United Kingdom

Hammond  
Electronics Ltd.  
1 Onslow Close,  
Kingsland Business Park,  
Basingstoke, Hampshire,  
RG24 8QL, England  
P. +44 1256 812812  
F. +44 1256 332249  
[sales@hammond-electronics.co.uk](mailto:sales@hammond-electronics.co.uk)