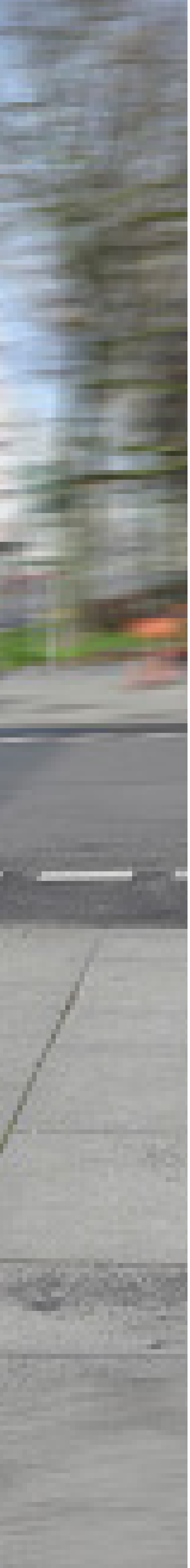
Essential

Annual Report 2020

HPS Hammond Power Solutions Inc.



Oliver Hammond along with his sons started a business in 1917 just before the deadly Spanish Flu pandemic spread worldwide from 1918-1920 claiming at least 50 million lives. The business survived as did its founders, to carry on and establish what we know today as Hammond Power Solutions. And here we are again, the year is 2020 and the deadly pandemic that has swept the globe is Covid-19. The pandemic is not over, in fact some say we're right in the middle of it and its effects will be felt for years after.

There isn't a business or a person that wasn't changed by the year 2020. For far too many it meant loss of life and devastating change. Our hearts reach out to all of those affected with the loss of a loved one or long-term effects of the virus. Covid-19 will forever be etched in our society and will have forever changed our lives.

The word **essential** took on a more impactful meaning in 2020. Essential has always meant fundamental, vital and indispensable but in 2020 essential also meant survival – it was a defining word that kept society safely functioning and is trending to be one of the most significant words of all time.


ON

Electricity is a very versatile, easily controlled and essential form of energy. It can be converted into useful power without losses and pollution and at the point of generation, it can be produced clean through renewable methods such as wind, water and sunlight.

An essential part of converting electricity to power is a transformer. Without either, the simple act of flicking a switch for instant power wouldn't be possible.

Modern society relies on electricity to function. When Covid-19 swept across the globe in 2020, people took to their homes – reorganizing their lives with home offices, using e-commerce sites to do their shopping and streaming video platforms for entertainment. Electricity was critical for operating ventilators and other medical equipment in the hospitals treating the afflicted.

HPS organized and took action finding ways to keep people and places powered up and powered on. Not only were we classified as an "essential" business in 2020, we continued to be an essential product – one that the world can't live without now more than ever.

Essential isn't a new word or concept to the people at HPS – Essential has been the heartbeat of our company for 100 years.

We've been able to weather the storms we've faced over the last century because of the value we place on our essential customers, people, relationships and shareholders – each playing a key role in our ability to manufacture an essential product and deliver solid financial performance.

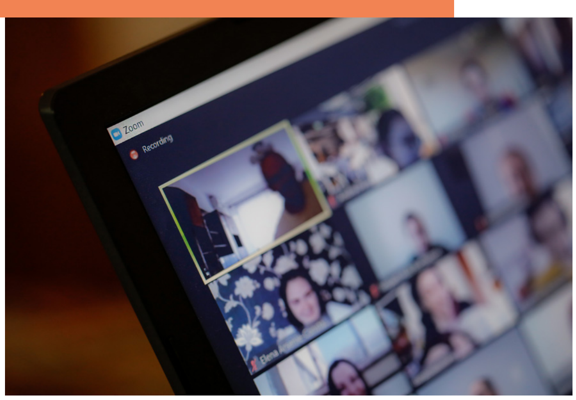
Our people are essential – the ones that work in our plants and offices as well as those adjusting to working from home. Our customers are essential – the ones that need us most to help others and to stay afloat themselves. Doing our part in the supply chain and forging strong supplier relationships is essential – the organizations, people, information and resources that depend on one another to deliver products to customers. Sustainability is essential – how we create long-term value through innovation, infrastructure upgrades and more efficient production standards. And our shareholders are essential – the ones that believe that we can consistently deliver operationally.

At Our Core

Essential People

People are an essential part of our business success and are at the core of everything we do. HPS employees are part of a valued and supportive team. We have a passionate interest in energizing the careers and nurturing the personal growth of our people, supporting them through the training and education that help them to develop new skills. We foster diversity and inclusion and with that we offer fair and equitable compensation as well as an environment where we care about our people's safety and well-being. We believe that everyone's role in the company is essential to our success.

At the start of the pandemic, like all businesses deemed essential, we initially reorganized our work force to allow for physical distancing not only in our manufacturing facilities but also in our office areas. Where appropriate, employees began working from home and adjusted hours to meet the needs of their family. We designed and implemented rigorous company-wide safety protocols. This gave way to more transformational change within our organization as we identified risks, assessed impacts and redefined our scope of work.



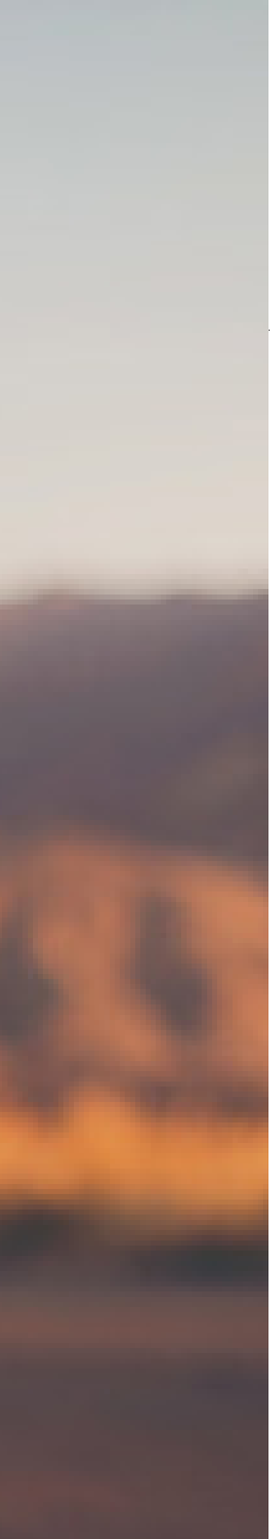
Fast-forward to Today

Essential Customers

When Covid-19 shut the world down, we waited in anticipation for the green light to continue business. We were fortunate to be identified early as one of the companies of choice, providing hundreds of distribution transformers to power newly constructed, expanded and renovated hospitals and testing centres as well as life-saving medical equipment.

In 2020, Google, Facebook and Amazon invested significant money to improve their networks in order to handle the massive increase in data load as we all were forced to move inside and online. Worldwide data centre upgrades, critical to our ability to communicate resulted in record sales of transformers specifically designed to power those centres.

As life moves on the world is turning to smart electrification using electrical energy sources such as sun, wind and water to replace other forms of energy such as fossil fuels. Smart electrification means using the advantages electricity offers to make overall better use of energy. Transit and light rail as well as safe water projects, utility upgrades and other major infrastructure projects rely on our essential product to provide transformers to move forward.



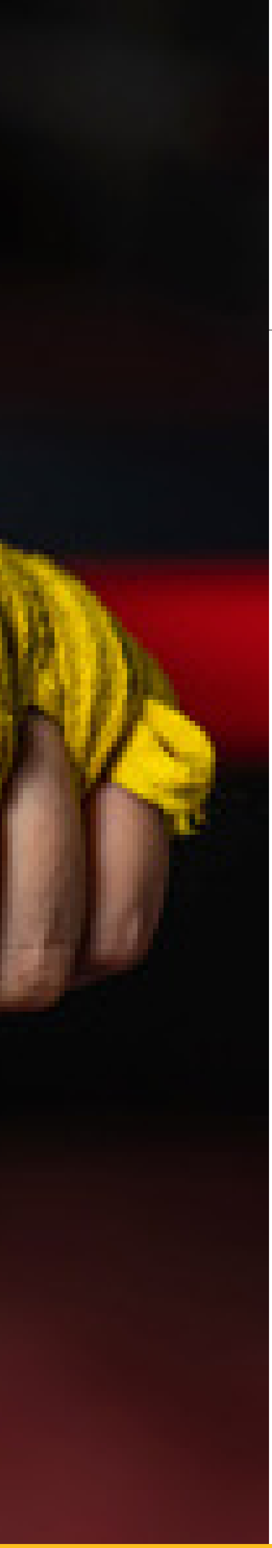
Reliable Heros

Essential Product

Transformers are essential to delivering electricity. They work to improve the safety and efficiency in power systems by increasing and decreasing voltage levels when needed. Power and distribution transformers work together to enable the transmission of electricity. Power transformers receive electricity at extremely high voltages and step that voltage down to lower levels delivering it to power our lives through distribution transformers.

A transformer is one of those unsung and reliable heros of the modern world, functioning as it should in the background of our lives.

The longevity of our company, coupled by our solid business practices, innovation and diverse range of markets has enabled our essential products to be products of choice.



Strong and Sustainable

Essential Shareholders

During the most taxing social and economic challenges Hammond Power Solutions has faced in our history, we have delivered solid financial performance and market share gains.

Our shareholders have stood by us through the good times and the unprecedented times as we continue to deliver our strong commitment of operational and financial strength. Generating long-term value for our shareholders is important to us as their support enables us to invest, grow and innovate. We are committed to transparency and are thankful for the value and trust our shareholders continue to place in us.

We continue to focus on creating long-term value through innovation, relationships, infrastructure upgrades and more efficient production standards.

To our Shareholders,

After such a calamitous and uncertain year, I am very pleased to report Hammond Power Solutions Inc.' ("HPS") 2020 results.

We like everyone else certainly did not foresee dealing with a global pandemic and recession, as well as the impact that these events have had on our customers, our employees and our suppliers.

Recognizing that transformers are integral to the functioning of everything powered by electricity, our business was deemed essential in all of the countries where we have operations. This however did not prevent our business, particularly in Canada and India, from being very adversely affected by nationwide lockdowns in the second quarter where we saw our domestic sales drop dramatically in these two countries.

Fortunately, in Canada, our government provided financial support which allowed us to maintain employment levels in our four Canadian manufacturing and warehouse facilities, and as a result we were able to rebound quickly when business began to recover in the third quarter.

True to our corporate values, when COVID began to roll across the globe we immediately focused on the health and safety of our employees and their families. Building on the contingency plan we had developed to protect our business during the SARS outbreak in 2003, we quickly implemented a number of protocols including remote working, physical distancing in the work place, mask usage and extensive cleaning and sanitization measures. As a result, we were able to minimize the infection rate of our employees and as best as possible protect the welfare of their families. This also enabled HPS to operate safely while continuing to serve the needs of our distributors and customers during a time when a number of our competitors were forced by local authorities to close their operations due to high infection rates.

Throughout the year, we made very conscious decisions about how we were going to run our Company with a focus on the health and welfare of our employees and their families as well as continuing to serve the needs of our customers throughout the pandemic. During this most challenging time it was through the dedication and tremendous support of our employees and suppliers, that we were able to not only meet, but to exceed our goals – certainly more than we thought would be possible back in March and April of 2020 when the dark cloud of COVID descended over the world. I have never been more proud of our company, our people, our suppliers and our accomplishments. Thank you to all who have made this possible.

As the economy slowly comes back to life, I firmly believe that Hammond Power Solutions will be even stronger and more successful going forward into this decade.

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

Our Values

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

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

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

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

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

Our Vision

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

Our Mission

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

Ready to Respond

An Essential Service

HPS has a rich and extensive history of growth, innovation and resilience. As an essential service HPS has always had to ensure we were ready to respond – to our shareholders, customers and employees.

For our shareholders, HPS has provided:
- Escalating growth of the NAED channel;
- New global customers;
- Expanded relationships with existing customers;
- Capital investment in North American manufacturing facilities in Canada, the U.S. and Mexico;
- Establishment of a state-of-the-art core manufacturing facility in Mexico;
- Healthy gross margin rates, strong earnings per share, solid cash generation; and
- Quarterly dividends paid with an attractive yield.

For our customers, HPS has provided:
- Compliance with regulatory changes;
- New product development;
- Expanded product offering using cast resin technology;
- Superior customer service;
- Accurate ship on time; and
- Competitive pricing for our products.

For our employees, HPS has provided:
- The tools to facilitate their best work, which includes development and further implementation of our ERP system to enhance availability of information and streamline processes;
- Space and time for innovation and development;
- Safety in the workplace, especially during COVID-19; and
- Ability for remote work, where able, to help manage school closures and health concerns.

Competitive and Strategic Advantage

Focused on the Future

HPS is confronting future challenges and continuously building our competitive and strategic advantage while being cognizant of the importance of our shareholders, customers and employees.

For our shareholders, HPS is focusing on:

- Disciplined cost management initiatives to ensure price competitiveness in the market;
- Cash flow generation;
- Capital investment in capacity expansion and information systems; and
- Strategic planning.

For our customers, HPS is focusing on:

- Sales development;
- NAED channel expansion;
- Broadened product offering;
- Product development; and
- Bringing quality and value to all that we produce.

For our employees, HPS is focusing on:

- Investing in our employees, through leadership training and development programs;
- Implementing a new Human Resource information system to provide an in-house payroll system, dynamic performance evaluation module, succession planning, personal learning development and people management tool;
- Relaunch of our internal continuous improvement program, Transform, to further foster a culture of innovation; and
- Ongoing support through the CEWS wage subsidy where we qualify.

Moving Forward Through Innovation

Renewable and Innovative Power

As utilities look to the future when many traditional forms of power generation go offline and a substantial portion of smaller individual generation point feed the grid, HPS is able to provide a solution with our zigzag grounding transformers. The flexibility of our custom manufacturing, reputation in the distribution channel, and dedication of HPS sales staff has cemented this as a true success story.

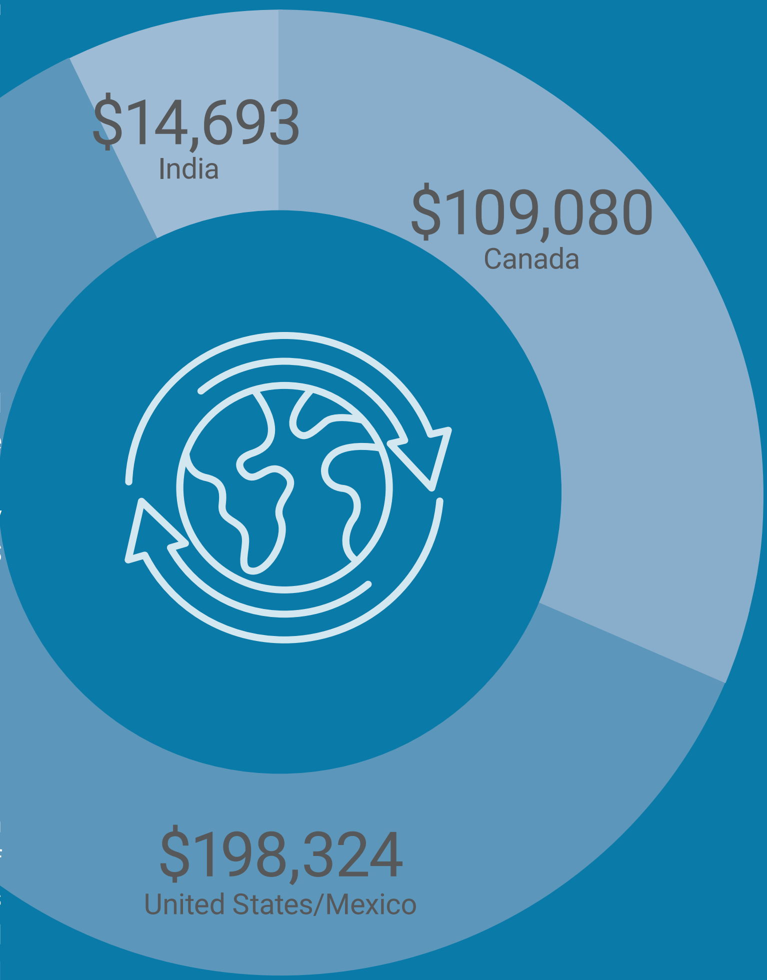
Handling the Data Load

This past year Google, Facebook and Amazon invested more money to improve their networks to handle the massive increase in load as we all moved 'Inside". HPS' distribution and power products are specifically designed to support these data criical centres. HPS is part of these essential parts of today's society.

Moving People

Transit and light rail systems reduce traffic congestion and pollution by providing an accessible means of affordable transportation for city centres. HPS has provided custom transformers to suit various transit and light rail projects in North America and are positioned to continue to be a major part of additional projects over the coming years.

Geographic Sales
(in thousands of dollars)



Healthcare Response

HPS is proud to do our part in support of the healthcare community. Our transformers are part of exisiting hospital upgrades and additions as well as field and portable hospitals and testing centres that were set up in parts of the Canada and the United States. Our inventory positioned us to be able to react quicker than any other manufacturer as these transformers are standard product for HPS. Distribution transformers are integral parts of the “step down” voltage powered life-saving medical equipment that is reliant on clean power. HPS supplies and continues to invest in developing the best products to produce the best power quality solutions for this equipment in the industry.

Safe Seawater Systems

Containerized Seawater Reverse Osmosis systems are designed to take the salt and pollutants out of seawater making it safe for consumption. A new system developed in the U.S. will be able to produce 300,000 GPD (1,136 m3/day) of high-quality water. Engineers were able to overcome many challenges to provide advanced Seawater Reverse Osmosis systems suited for communities all over the globe. HPS was in the on the ground floor of this new technology supplying transformers to be included as part of this highly advanced and efficient system.

HPS Academy – Online Training Center

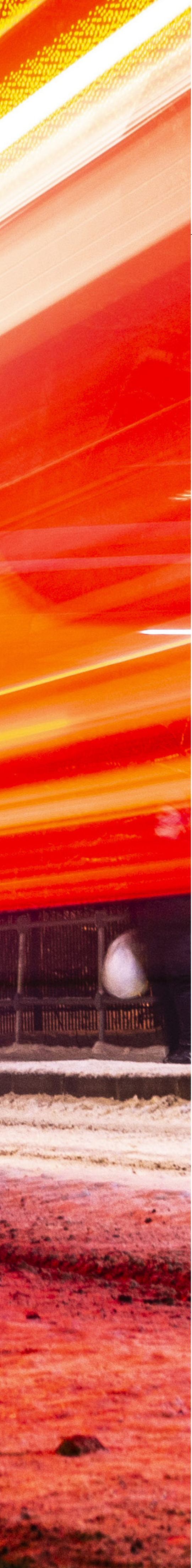
Several years ago we laid the foundation for the development of a training system for HPS customers. We are very proud of the robust system that has become the HPS Academy – Online Training Center.

HPS Academy is not only a place where customers can access valuable specification information as well as product features and benefits, but it also aids with providing information about application challenges accessible anytime and from anywhere!

As a result, Hammond now has the largest and best E-commerce platforms of any dry transformer company in North America with mobile device capabilities being utilized by Contractors in the field. We also have over 50 training modules and videos available online which has given us a tremendous advantage over the competition, especially given the large demographic turnover in our industry and the significant loss of knowledge and experience.

10,458
Year to Date Enrollments

10,629
Year to Date Course Completions



A Review of Operations

HPS had a very positive year in 2020 – despite the global pandemic and political unrest. Although our year-over-year sales were down, in comparison to other electrical manufacturers of industrial and commercial products our decline was small and we experienced positive growth in some regions and markets. We firmly believe that HPS will come through this time in a stronger market share position.

A number of core strategic advantages have long benefitted HPS and paved the way for our years of success – primarily our business diversity. No other dry-transformer company has the same range of geographical economies, end-markets, channels and product capabilities as HPS does. Our diversity has not only resulted in more rapid growth than our competitors, it has also lessened our dependency on any one or two end user markets.

Prior to 2017, HPS was much more dependent on the highly cyclical oil and gas, as well as mining markets than we are today. In economic boom times, these two markets represented over 25% of our business. Unfortunately, over the last twenty years we have also experienced three significant down turns, the most recent in 2020 with sales in these markets falling by as much as 40%. Conversely since 2015, we have strategically added over 1,700 distributor branches across the United States (U.S.). Selling our product through this larger and more dominant network of distributors has not only opened the doors of growth opportunities such as we have never seen before, but also diversified our business across a broader spectrum of markets and customers. As a result, HPS transformers are being used in power solar and wind generation, EV recharging stations, water and sewage treatment facilities, hospitals, data centres, automotive plants, Amazon distribution centres, condominiums, transit systems, power systems for naval ships, university research buildings and chemical refineries. Now with the start of a potential commodity boom driven by a recovering global economy, our oil drilling and pumping, as well as our surface and underground mining equipment business, is expected to grow over the next several years – an unexpected boost to our overall sales.

An equally important core advantage of HPS is our company and employee culture. There are many words and phrases that our distributors and customers use to describe HPS, including humble, driven by family values, passionate, hardworking and focused on serving our customers. We are a flat organization that works hard at being fast and flexible. One of our independent agents responsible for selling our products in the U.S. recently said that "Hammond personifies the 'Easy Button'." It took some time to change our way of thinking and doing things, but as a Company we do whatever we can to build effective relationships with our distributors and customers, understand their needs and work hard to meet them as best we can.

As with many companies today, we are going through a transition as long-term managers are retiring. A number of individuals who have been very instrumental in building HPS over the last 20 years from a new and separate public company of $65 million in sales to the dominant North American manufacturer of dry transformers with sales of over $320 million, are moving towards retirement. With the guidance of our Board of Directors, we have been building a solid succession strategy to ensure that we have a combination of talent through internal development as well as external recruitment to fill these key positions. Going forward, this will ensure we protect our unique culture as well as build upon our sound foundation with new ways of thinking and external best practices. We are very excited about this evolution of HPS and how it will help us grow in new and different ways, while at the same time respecting our family business values, the passion we have in everything we do, the development of effective customer relationships and our relentless focus on service and quality.

The onslaught of the global pandemic changed our original 2020 growth objectives. We had entered the year with a number of exciting strategies to grow our business including an aggressive expansion into the Mexico and Latin America markets as well as further expansion of our power quality business. Although we continued to execute these plans as best we could, the significant economic slowdown and broad shut-down of businesses across North America impaired our ability to deliver our 2020 objectives. Our most important priorities became the welfare of our employees and minimizing as best we could the financial impacts of this global pandemic recession.

Given the critical importance of transformers to the fundamental functioning of anything powered by electricity, HPS was at the onset of the pandemic, classified as an essential business in all of the countries where we have operations. This did not however spare us from a complete shutdown of our Indian operations as the Indian economy plunged in April and May, in turn having a calamitous impact on all Indian electrical companies during the middle portion of the year.

When some of our competitors in North America suspended operations for a period of time due to high COVID-19 infection rates within their facilities, HPS through the tremendous support of our employees and suppliers, was able to continue operating and serving the needs of our customers and markets for the entirety of 2020. This continuity of business had a positive effect as we were able to lean on our strengths to increase our sales and market share, in spite of a slowdown in the economy.

In early March when there seemed no doubt that a very disruptive pandemic would wreak havoc on the world and our business, we made a conscious decision to increase our finished goods inventory. This strategy was in part, insurance in the event that the pandemic created service issues with our suppliers, and put us in a stronger position to take advantage of any similar issues that our competitors might face. A number of our competitors experienced major disruptions and our distributors, supported by our strong inventory, were able to expand our market share. Our superior inventory position also attracted new distributors and customers who were unable to fill their transformer requirements through their usual channels and hence began to place orders for our products. We believe the majority of this business will remain with HPS after our competitors return to normal business practices.

In addition to expanding our finished goods inventory, HPS maintained our staffing levels while many competitors reduced theirs. We also continued to invest in our online/digital capabilities which became an even more important service as the year progressed. HPS now has the largest and best e-commerce platforms of any dry transformer company in North America with mobile device capabilities being utilized by contractors in the field. We also have industry leading training modules and videos available online which has given us a tremendous advantage over the competition – especially given the large demographic turnover in our industry and the significant loss of knowledge and experience. Our overall support and flexibility, compared to other manufacturers throughout the pandemic, combined with our agility and willingness to do whatever we can to help our agents, distributors and customers, has solidified HPS as the dominant dry transformer company in North America.

Although our performance was better than most other electrical manufacturers in the industrial and commercial markets, especially during the worst economic collapse since the Great Depression, we did experience an overall 10% drop in sales from 2019 levels. The effects of a global pandemic caused an unplanned pause in our growth trajectory towards a target of $500 million in sales by 2025.

Our Canadian business in particular was hit especially hard in the second and third quarters, falling by almost 25% compared to the same period in 2019. Our U.S. distributor business was not impacted as negatively, primarily because shutdown measures imposed by State and Federal governments were not as severe and complete as in those imposed in Canada.

Our resource-related Original Equipment Manufacturer (“OEM”) business was another area hit hard by the global pandemic in 2020. This business was already suffering by slowing demand and falling commodity prices in 2019, however the economic shutdown of the global economy, especially China, along with the need to close plants temporarily created the worst business conditions for these OEMs in over twenty-five years. As a result, we saw sales decline by as much as 80% some of which occurred during the first three quarters of 2020.

Approximately a third of our business is related to longer-term industrial and commercial projects and understandably with the great uncertainly created by the pandemic, the vast majority of these projects were put on hold across North America. Without a doubt, the pandemic had the biggest impact on the North American economy in 2020, HPS continues to however, invest in our future and grow our business. With a conscious decision to reduce spending and focus on maintaining a strong balance sheet, we continued to invest in several projects that would expand our business and scope into 2022 and beyond. A new endeavor initiated in 2019 expands HPS into the power quality market. The events of 2020 somewhat slowed our progress on this project, yet we were able to recruit resources as well as add internal manufacturing and test capabilities to set the stage for growth beginning in 2021. We continue to look for opportunities to expand our product offering through acquisition(s) in addition to adding to our engineering talent and broadening our product capabilities internally.

The groundwork for expansion into the Mexican and Latin American markets continues, as we build on our manufacturing presence in Monterrey where we have three facilities and a very engaged workforce. At the beginning of the year, we began to put in place the sales structure to lead this geographical expansion and continued working on product development, as well as building relationships "virtually" with Mexican distributors who are eagerly awaiting our revised launch, slated for Quarter 2 of 2021. We are very excited about the promising opportunities in Mexico and Latin America and believe that within five years we can become the largest dry transformer supplier in this part of the continent.

In addition to these projects, we made a significant investment of capital, time and resources in continuing to upgrade our business systems across the organization. In 2020 we accelerated the process of converting the business systems of our Delta entity operation to our Microsoft AX platform. At completion in 2021, all of our operations and entities including India will be on our common financial and business planning systems platform. This work and investment continues into 2021 as we ready the migration of our ERP and e-commerce platforms to the Cloud, which will be finalized in 2022.

We are also implementing a new Human Resource Information System corporate-wide, which will be expanding and integrating the capabilities to serve our employee population.

Lastly, we are continuing to invest in engineering design software as well as shop floor data automation. These investments will have a variety of benefits for the Company including more consistent quality, higher efficiency, lower costs, faster flow of designs and information, additional tools for better decision making and a higher level of data security.

Looking forward, we are very optimistic with regard to our growing momentum in 2021 and 2022. Despite the delays in vaccine rollouts across North America there is a growing overall sense of optimism, which at some point will translate into a stronger economy.

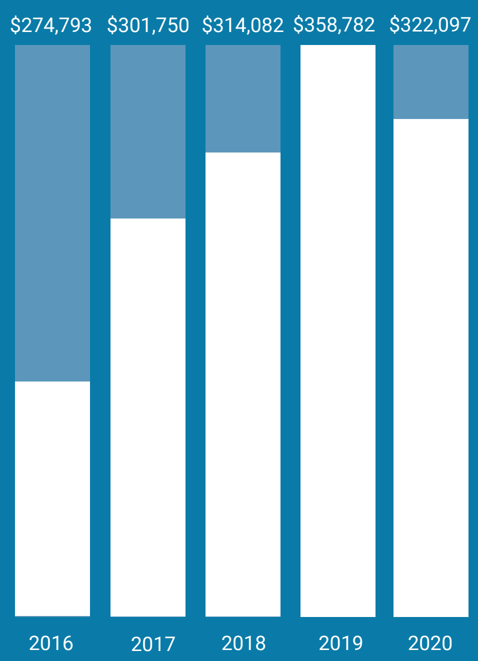
As mentioned earlier, a large number of industrial and commercial projects were put on hold in 2020 due to the significant volatility and uncertainty created by the pandemic. Over the last several months, we have begun to see many of these projects re-instated and rescheduled over this year and next. We are seeing growth coming from a wide spectrum of markets including data centres, hospitals, food and beverage companies, distribution warehouses such as Amazon, water and sewage treatment facilities, automotive plants, transit and public infrastructure, as well as condominiums. Most of this growth is coming through our expanding distributor network as we continue to add new distributors and more branches of existing distributors because of our increasing market dominance and share. We are even starting to see the unexpected revival of our OEM business due to the rising consumption of commodities and higher commodity prices brought on by a growing global economy especially in China. Finally, we are beginning to see the Indian economy starting to recover after its long and broad shutdown nationally. Many of our Indian independent competitors have suffered financially through 2020, and this situation is opening up a variety of opportunities for HPS.

As the world wobbles to some degree out of this long and serious health crisis we have to be very mindful of the potential risks, at least those that we can see at this point. Clearly there is a growing concern about re-occurring spikes of infection from the virus mutations that are now surfacing. Who knows what impact these will have on the global and North American economies over the next twelve to eighteen months. There is certainly hope that with the expanding availability of new vaccines and the attainment of some degree of herd immunity, these effects can be muted. But we all have to be very cognizant of the significant impact that the pandemic and shutdowns have had on the economy and high unemployment. It may take years for some sectors to recover just to 2019 levels. It is inevitable that high levels of personal and government debt will contain spending for years to come which in itself will slow this recovery.

I am very proud of the overall performance of our Company during the most challenging global environment since the Great Depression. This pandemic and its significant impact was something that none of us imagined as we rang in 2020 – expecting our strong growth momentum to continue. Our focus and priorities immediately switched to the welfare of our employees and their families while at the same time getting prepared to do whatever was necessary to protect the financial health of HPS and its future. As a result of the hard work and support of our employees; our diversity of geography, channels, markets, and products; the benefits of our many competitive advantages built around customer service; and finally with some luck - we were able to deliver respectable financial performance and position ourselves even more positively for the decade to come. I am convinced, that Hammond Power Solutions will come through this deep pandemic valley of 2020 in a stronger market position with even more opportunities in 2021 and beyond!

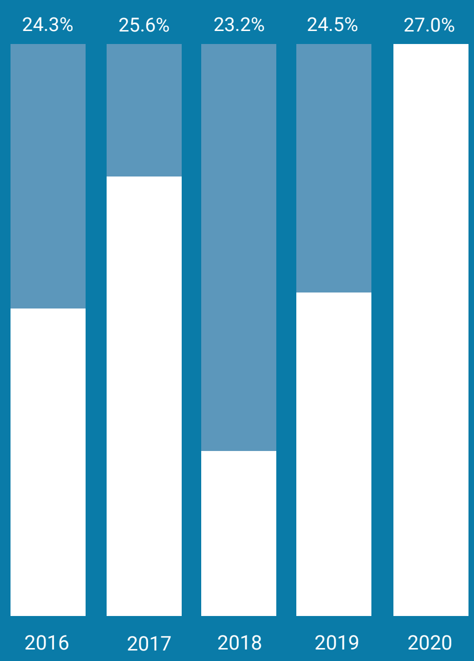
Consolidated Sales*

(in thousands of dollars)



* from continuing operations

Gross Margin %*



* from continuing operations

COVID-19 Business Update

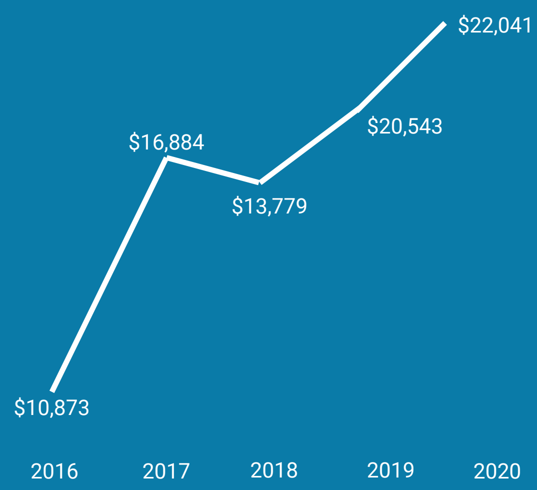
HPS is committed to managing the impact the pandemic will have on its financial performance through:

- Robust health and safety precautions;
- A dedication to providing a safe working environment for our employees;
- Continuing to serve our customers during this volatile and unpredictable time;
- Robust health and safety precautions;
- A dedication to providing a safe working environment for our employees;
- Continuing to serve our customers during this volatile and unpredictable time.

HPS has performed very well during these erratic and unpredictable times and remains steadfast in its execution of its operational and strategic plans.

Earnings from Operations*

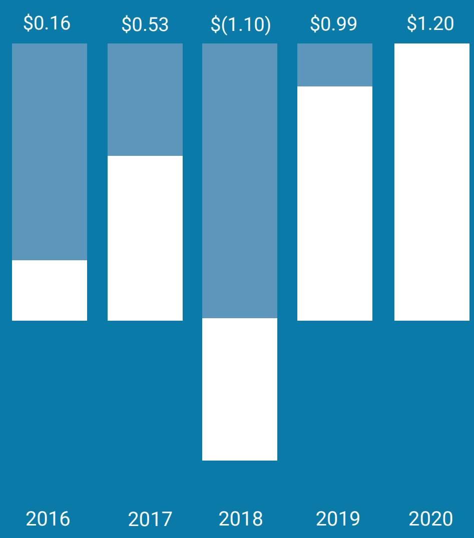
(in thousands of dollars)



* from continuing operations

Basic Earnings (Loss)* Per Share

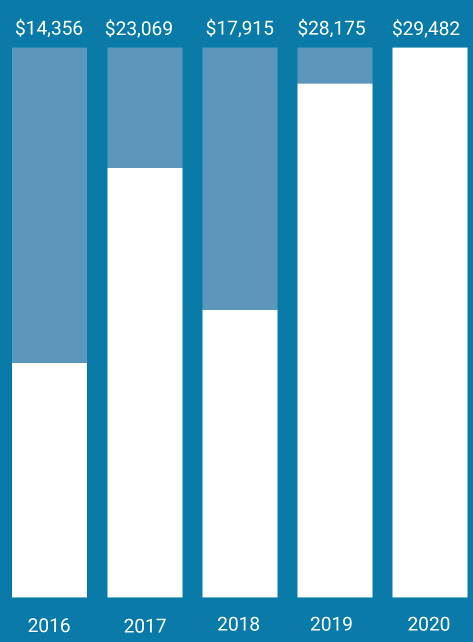
(in dollars)



* from continuing operations

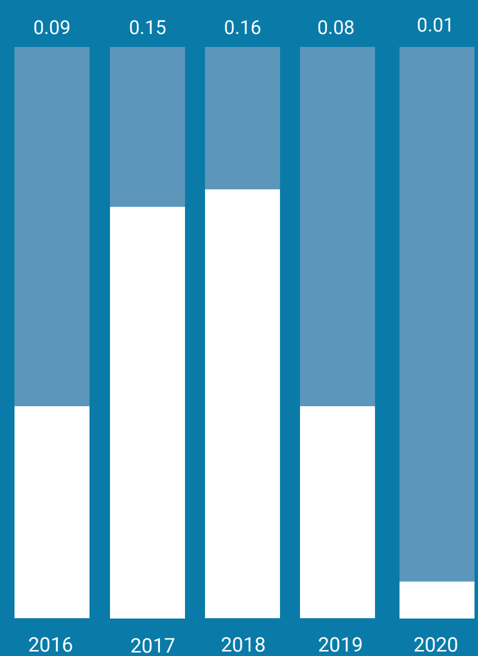
EBITDA*

(in thousands of dollars)

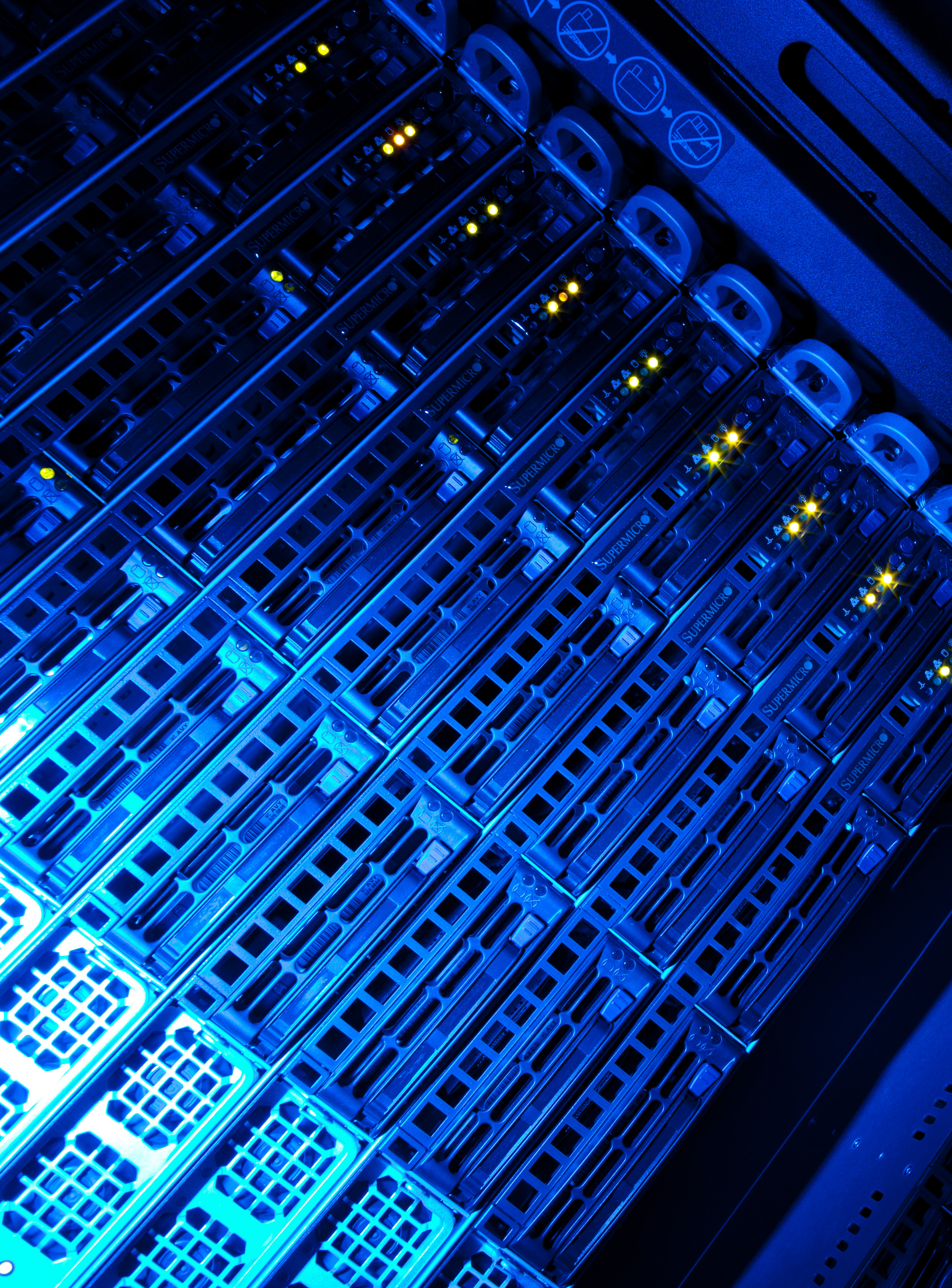


* from continuing operations

Net Operating Debt** to Equity



** operating line drawings net of cash


SUPERMICRO

Management’s Discussion and Analysis

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

The following is Management’s Discussion and Analysis (“MD&A”) of the Company’s consolidated financial position and performance for the years ended December 31, 2020 and 2019, and should be read in conjunction with the accompanying Consolidated Financial Statements of the Company as at December 31, 2020 and 2019, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”). This information is based on Management’s knowledge as at March 25, 2021. All amounts in this report are expressed in thousands of Canadian dollars unless otherwise noted. Additional information relating to the Company may be found on SEDAR’s website at www.sedar.com or on the Company’s website at www.hammondpowersolutions.com.

Caution regarding forward-looking information

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

Additional GAAP and Non-GAAP measures

This document uses the terms "earnings from operations" which represents earnings before finance and other costs/(income) and income taxes. "EBITDA" is also used and is defined as earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA from continuing operations represents EBITDA from continuing operations adjusted for foreign exchange gain or loss. Operating earnings, EBITDA and Adjusted EBITDA are some of the measures the Company uses to evaluate the operational profitability. The Company presents EBITDA to show its performance before interest, taxes and depreciation and amortization. Management believes that HPS shareholders and potential investors in HPS use additional GAAP and non-GAAP financial measures, such as operating earnings, EBITDA and Adjusted EBITDA in making investment decisions about the Company and to measure its operational results. A reconciliation of earnings from operations, EBITDA and Adjusted EBITDA to net earnings for the years ended December 31, 2020 and December 31, 2019 is contained within this MD&A. Earnings from operations, EBITDA and Adjusted EBITDA should not be construed as a substitute for net earnings determined in accordance with IFRS.

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

The Company's 2020 consolidated financial statements, which comprise the consolidated statements of financial position as at December 31, 2020 and December 31, 2019, the consolidated statements of operations, comprehensive income , changes in equity and cash flows for the years ended December 31, 2020 and December 31, 2019, and Notes thereto, have been prepared under IFRS.

Overview

HPS is a transformer industry leader, providing superior quality, custom engineered and standard product solutions, broad offerings and market access through multiple sales channels which makes us an essential service business and has allowed us to continue to operate during the global coronavirus ("COVID-19") pandemic. HPS has continued to produce transformers for our customers throughout the entire pandemic period while also supporting and ensuring employee safety during this time. The pandemic has had a significant impact on our business 2020 and continues to influence our daily operations.

Demand for our product is stable, however sales volumes will be determined primarily by which industries and customers are continuing to operate and in what capacity. Later in the year we saw activity in the project and industrial markets that had stalled when the pandemic gained momentum in North America while other markets continued to struggle. The Canadian lockdown imposed in early 2020 and again in early 2021 continues to impact several of our markets.

HPS' North American sales volumes experienced a reduction in 2020 as COVID-19 impacted many of our customers' industries. While our sales dollars have declined, our market share continues to grow thus mitigating some of the decline that many companies in the electrical industry have seen. The Company continued to escalate its North American market share growth, particularly through its North American Electrical Distributor ("NAED") channel. While our sales volume declined, our financial results were supported in other ways – varied sales mix, achieved price increases, decreased commodity costs, receipt of the Canadian Emergency Wage Subsidy ("CEWS") benefit and cost reductions.

The Company has incurred significant costs related to COVID-19 to ensure the safety of our employees. HPS has been fortunate that there have been a limited number of cases impacting our employees and their families to date. We continue to ensure our efforts do not waiver as the length of the pandemic continues to extend. HPS' health and safety practices, including remote work where possible, have allowed the Company to continue to operate during the pandemic ensuring business continuity and supplying our customers with the products they need.

HPS' history of success has been achieved through its commitment to producing quality, innovative, energy efficient, diverse transformers and related magnetic products. The Company's alignment of its operational initiatives and strategic vision enhances these competitive differentiators. HPS has a well-established and growing market presence and a focus on continued growth through current and new customers and products.

The Company has a strong financial footing that allows for continued focus on market share growth. The Company's increased global footprint provides a gateway to new technologies, customers and markets. These strengths are important to future revenue and earnings growth.

Technology and know how obtained through acquisitions have allowed the Company to accelerate the research and development program of its cast resin transformer technology and product development which are now manufactured in several HPS facilities.

Despite the challenges, 2020 was a successful year financially for HPS. Solid sales and marketing strategies increased organic customer sales and market share growth was realized in markets not as heavily impacted by COVID-19. Increased gross margin rates combined with excellent manufacturing performance as well as effectively managed general and administrative expenses positively impacted HPS' profitability and financial performance. The financial performance of Corefficient was reasonable as the joint venture experienced decreased revenues due to COVID-19.

Looking forward, in an effort to deliver resilient financial performance, HPS continues to concentrate on sales growth, gross margin generation and operational improvement. Globally in the U.S., Canada and Asia, HPS is well situated for electrical industry market share growth and continues to be a leader in the markets it serves. The Company continues to build market presence through its product capabilities, product quality, cost effectiveness, service and geographical market expansion.

While we experience some sales variability with fluctuations in the markets and those of our customer industries which have a direct impact on our revenue, there are indications that overall market activity will be fairly robust. Booking rates have decreased from 2019 but are still at a healthy level going into 2021. The benefit of the HPS diversified market approach allows for the capitalization of growth in expanding market segments, while counterbalancing the impact of cyclical market declines. A portion of annual sales are derived from major customer projects, for which exact timing continues to be difficult to predict and will influence quarterly sales fluctuations. Order booking rates continue to grow in strategic target markets delivering additional market share penetration, new account development and expansion of organic sales. HPS is consistent in calculating the risks and opportunities that are present and unyielding in the execution of our strategies; there are many opportunities to be recognized.

The industry outlook is very difficult to predict as the full extent of COVID-19 continues to be unknown. While vaccinations will begin to positively improve the economy, the timing of when the majority of the population will be vaccinated is very unclear given delays in shipments and worldwide ingredient shortages. As always, we expect to see some global economic growth in certain sectors yet declines in others. We are optimistic in continued market improvement later into 2021, particularly in North America. HPS is cognizant of the resource-based commodity cost uncertainty, the variability of foreign currencies and the growing risks to the global economy caused by trade wars and the impacts of tariffs.

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

The combination of a secure financial foundation, strong business fundamentals and strategic vision positions HPS for growth as well as creating stakeholder value. The future of HPS is not only in its focus on market share and sales growth, but also on improving its cost competitiveness. The Company maintains a strong and stable balance sheet and excellent liquidity supported by a committed credit facility available to implement investment strategies, operational plans and advance growth initiatives. The Company's current North American credit agreement matures in June 2021. The Company is currently in the process of finalizing a new 5-year agreement.

HPS gained significant momentum in 2019, continued to hold steady in 2020 and is positioned well to continue to grow and execute its vision into 2021.

Sales

Sales from continuing operations in 2020 were $322,097 as compared to sales of $358,782 in 2019, a decrease of $36,685 or 10.2%.

U.S. market sales (stated in Canadian dollars) were $198,324, a decrease of $27,385, or 12.1%, compared to 2019 sales of $225,709. U.S. sales, (stated in U.S. dollars), have decreased from $170,073 in 2019 to $147,561 in 2020, a decline of $22,512 or 13.2%. The U.S. market experienced declines in the motor control, private-branding, mining and NAED markets.

Sales were favorably impacted by the strengthening of the U.S. dollar relative to the Canadian dollar. The average U.S. to Canadian exchange rate for 2020 was $1.343 versus $1.327 in 2019, a U.S. dollar strengthening of 1.2%.

Canadian sales were $109,080, a decrease of $7,916 or 6.8% as compared to sales of $116,996 in 2019. The Canadian market suffered declines in the NAED, capital equipment and motor control markets.

Indian sales in 2020 were $14,693, a decrease of $1,384 or 8.6% compared to sales of $16,077 in 2019. The decline in India is largely COVID-19 related as the pandemic dramatically constrained the Indian market, leading to delays in projects because of government imposed lockdowns.

Stated by geographic segment, sales from continuing operations in the U.S. were 61.6% (2019 – 62.9 %), Canadian were 33.9% (2019 – 32.6 %) and India sales accounted for 4.5% (2019 – 4.5 %) of our total sales.

The Company experienced declines in North American sales through its established NAED and OEM channels which were significantly impacted by COVID-19, resulting in an overall drop in demand, project deferrals and cancellations. Despite the pandemic, HPS is growing its market share through distributor conversions and its custom transformer capabilities. The ability to continue to expand these segments is also a result of new customer additions, organic customer diversity, expanded product offerings and geographically diverse manufacturing capabilities. HPS is not single-market or industry dependent and our market diversification strategies provide a natural business hedge.

HPS is committed to its growth strategy through our focus on product development, innovative research and development projects, capital expenditure program to increase capacity, vertical integration strategies, business development activities and its expanded NAED network. The Company will continue to grow market share globally as a result of expanded product offerings, the addition of new customers, geographically diverse manufacturing facilities and market influence.

HPS prides itself on providing value to our customers. The Company is committed to consistent quality, competitive product design, expertise in custom engineered products and product breadth. These factors combined with a strong, effective distribution channel and multi-national manufacturing capabilities will continue to be a competitive advantage for the Company and important to continued revenue growth.

Order bookings and backlog

Overall, 2020 bookings decreased by 14.1% over the prior year. In 2020 direct sales bookings decreased by 22.3% and bookings in the distributor channel decreased by 8.4%. The decrease in both the direct and distributor channels can be directly attributed to the impact of the COVID-19 pandemic on overall business activity which first began in March 2020 and continues to persist. Although bookings were lower across a number of market and geographical segments, the Company still achieved increased market share in the distributor channel due to expansion in the number of distributors carrying the HPS line and late-year strengthening of demand in a broad base of market segments.

The Company's December 31, 2020 backlog decreased by 4.7% as compared to December 31, 2019, due to lower bookings in both channels but did increase 1% over Quarter 3, 2020. It is expected the combination of the Company's strategic sales initiatives, service, dominant distributor footprint and new product development will support booking rates.

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

Gross margin

The consolidated gross margin rate from continuing operations in 2020 increased to 27.0% versus 24.5% in 2019, an increase of 2.5% of sales. The improvement in margin rates is attributed to favourable sales mix, selling price increases, receipt of the CEWS benefit and cost reductions.

The CEWS program provides an employee wage subsidy for our Canadian entities for periods where there was a significant decline in Canadian trade sales due to the impact of COVID-19. During 2020, the wage subsidy received for production labour was $5,557 or 1.7% of sales. The Company did incur additional operating expenses of $1,902 during 2020 relating to amounts paid for suspended operational employee wages, non-productive wages support for "at risk" employees, employee transportation, increased cleaning, sanitation and personal protective equipment expenses for the safety of employees. Excluding the wage subsidy and COVID-19 related expenses, the Company still delivered an increase in its gross margin rate of 1.4%.

Demand for our product is stable, however sales volumes will be determined primarily by which industries and customers are continuing to operate and in what capacity. Later in the year we saw activity in some markets that had stagnated when the pandemic originally started in North America while other markets continue to struggle.

HPS continues to focus on price realization strategies and achievement of cost reductions in an effort to maintain or increase margin rates. Fluctuating markets, product mix and the effect of COVID-19 on the current global economy will have a short-term impact on financial results. Looking forward, the unpredictability of the economic, social and industrial impact of the pandemic and the effect on business activity, combined with a slightly decreased backlog provides an indication of predictability caution for 2021. HPS was identified as an essential service in all countries that we operate in, and was able to continue to manufacture with the exception of India where the country was in lockdown at the end of the first quarter and a large portion of the second quarter.

Margin rates can be sensitive to selling price pressures, volatility in commodity costs, customer mix and geographic blend. The Company continues to combat competitor short-sighted pricing strategies through its total value-added engineered solutions. HPS' focus during the year has been on execution of its selling price realization strategies and achievement of cost reductions in an effort to lift margin rates.

While some growth strategies can have a shorter-term dilutive effect on gross margin rates, the Company continues to focus on the long-term investment to fuel future growth. Gross margin rates are supported by the maintenance of market prices combined with material procurement and engineering cost reduction initiatives. The Company aggressively implemented a number of cost reduction and expense management initiatives to offset the lower absorption of factory overheads from the reduction in manufacturing throughput due to the lower sales. HPS is currently investing in the support of future sales growth and new product development.

Quotation activity, improving bookings and backlog from the end of 2020 as well as an encouraging sales outlook, continue to provide a degree of optimism for the future. Looking ahead, HPS remains cautiously optimistic for the future as growth will be realized in some markets along with a decline in others – underscoring the volatility of markets and sales demand. Over the past few years, to manage the impact of volatility, the Company widened its distributor footprint in North America, expanded its Indian market presence, implemented engineering and material cost reduction initiatives, invested in new product development and broadened manufacturing capabilities. A diversified geographic approach supports anticipated growth from implemented market strategies and subsequent economic improvement.

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

Selling and distribution expense

Total selling and distribution expenses from continuing operations were $40,217 for 2020 versus $41,476 in 2019, a decrease of $1,259 or 3.0%. On a percentage-of-continuing-sales basis, total selling and distribution expense increased to 12.5% of sales for 2020 from 11.6% in 2019. The increase in the percentage of sales is due to the reduced sales for 2020. Lower sales value for the year resulted in a lower commission expense of $560 and lower freight expense of $390 which are variable selling expenses that naturally decline with lower sales. Reduced travel expenses and the CEWS benefit of $776 or 0.2% of sales also contributed to the decline in expenses. These declines were partially offset by higher USD exchange rate.

General and administrative expense

General and administrative expenses from continuing operations in 2020 were $24,736 compared to $25,940 for 2019, a decrease of $1,204 or 4.6%. On a percentage-of-continuing-sales basis these costs have increased from 7.2% in 2019 to 7.7% in 2020. The increase in the percentage of sales is due to the reduced sales for 2020. During the year there was a reversal of an abnormal expected credit loss provision related to the settlement of the note receivable balance in the amount of $956.

The CEWS benefit related to general and administrative employees was $1,950 or 0.6% of sales, which was partially offset by a higher USD exchange rate. HPS continues to invest in growth while remaining very cognizant of prudent general and administrative expense management.

Earnings from continuing operations

Earnings from continuing operations surged, finishing at $22,041 in 2020, as compared to earnings of $20,543 in 2019 – an increase of $1,498 or 7.3%. The increase in earnings from operations is due to CEWS wage subsidy support off-setting lower gross margin dollars and increased operating expenses related to the pandemic.

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

	2020	2019
Net earnings from continuing operations for the year	$ 14,062	$ 13,306
Add:		
Income tax expense	6,904	5,882
Finance and other costs	1,075	1,355
Earnings from continued operations	$ 22,041	$ 20,543

Net finance and other costs

Net finance and other costs decreased $280 from $1,355 in 2019 to $1,075 in 2020. The decrease from prior year is a result of lower interest expense offset by a decrease in the foreign exchange gain and lower income from the joint venture.

Interest expense from continuing operations for the year-ended December 31, 2020 finished at $1,247 as compared to $1,739 in 2019, a decrease of $492. The decrease in interest expense year-over-year was due to the decrease in operating debt levels throughout the year – a result of lower working capital requirements. Interest expense includes all bank fees.

The foreign exchange gain from continuing operations in 2020 of $123 related primarily to the transactional exchange gain of the Company's U.S. dollar trade accounts payable in Canada, compared to a foreign exchange gain of $234 in 2019. The decrease of the foreign exchange gain for the year is related to the volatility in the exchange rates during the year – primarily the U.S. dollar which increased 1.2% relative to the Canadian dollar in 2020.

As at December 31, 2020, the Company had outstanding foreign exchange contracts in place for 17,500 Euros ("EUR"), $12,500 USD and 330,000 INR – all of which were implemented as an economic hedge against translation gains and losses on inter-company loans as well as $46,500 USD to economically hedge the U.S. dollar denominated accounts payable in Canadian HPS operations.

The ongoing volatility is managed by HPS' foreign exchange contract hedging program. Details of the outstanding forward foreign exchange contracts at December 31, 2020 can be found in note 29 in the Notes to Consolidated Financial Statements included in our 2020 Annual Report.

Earnings from continuing operations, before income tax

2020 earnings before income taxes was $20,966 as compared to earnings of $19,188 in 2019, – growing by $1,778 or 9.3%. The main contributors to the higher current year earnings before income tax were gross margin rate improvement, decreases in selling, distribution, general and administration expenses as a result of lower variable selling costs, focused expense management and government wage subsidy support in the current year offset by decreased gross margin dollar contributions.

Income taxes

Income tax expense from continuing operations for 2020 was $6,904 as compared to $5,882 in 2019 – an increase of $1,022 or 17.4%. The consolidated effective tax rate on earnings from continuing operations for 2020 increased to 32.9% versus 30.7% last year – an increase of 2.2%.

The Company's deferred tax assets and liabilities are related to temporary differences in various tax jurisdictions, primarily reserves and allowances, which are not deductible in the current year. A difference in the carrying value of property, plant and equipment and intangible assets for accounting purposes and for tax purposes is a result of business combination accounting and a different basis of depreciation utilized for tax purposes. The Company's income tax provision is explained further in note 16 in the Notes to Consolidated Financial Statements included in our 2020 Annual Report.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Net earnings from continuing operations

Net earnings from continuing operations for 2020 finished at $14,062 compared to net earnings of $13,306 in 2019, an increase of $756 or 5.7%. The increase in the net earnings from continuing operations is a result of gross margin rate improvement, decreases in selling, distribution, general and administration expenses as a result of lower variable selling costs, focused expense management and government wage subsidy support in the current year offset by decreased gross margin dollar contributions.

Discontinued operations and restructuring charges

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

During 2019, the Company continued the closure process of the Italian facility and was successful in selling the machinery and equipment, inventory and certain employee related liabilities to a third party. The Asset Purchase and Sale Agreement closed in late November 2019 for a sale price of 1,086 EUR (approximately $1,583) and resulted in a loss on disposal of 471 EUR (approximately $687). Also, as a result of this transaction, 1,369 EUR (approximately $2,035) of the 2018 restructuring provision for severances that were accrued but not paid was reversed. This recovery was partially offset by additional restructuring charges totaling 897 EUR (approximately $1,307) for cancellation costs, legal fees and additional expected credit losses. These restructuring costs are included in loss from discontinued operations in the Financial Statements. The loss from discontinued operations for 2019 was $1,699.

The 2020 Italy operations consist of investment properties which has been consolidated into continuing operations. During 2020 the cancellation and closure costs of $855 were paid and $92 of the provision was reversed into income. The expected credit loss related to the VAT receivable continues to be provided for and is included in the net accounts receivable value in the amount of $339.

EBITDA

EBITDA from continuing operations for the year-ended December 31, 2020 was $29,482 versus $28,175 in 2019 – an increase of $1,307 or 4.6%. Adjusted for foreign exchange gains, adjusted EBITDA for 2020 was $29,359 versus $27,941 in 2019 – an increase of $1,418 or 5.1%.

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

		2020		2019
Net earnings from continuing operations	$	14,062	$	13,306
Add:				
Interest expense		1,247		1,739
Income tax expense		6,904		5,882
Depreciation and amortization		7,269		7,248
EBITDA from continuing operations	$	29,482	$	28,175
Subtract :				
Foreign exchange gain		(123)		(234)
Adjusted EBITDA from continuing operations	$	29,359	$	27,941

Summary of quarterly financial information (unaudited)

Fiscal 2020 Quarters	Q1	Q2	Q3	Q4	Total
Sales	$ 88,420	$ 75,393	$ 78,115	$ 80,169	$ 322,097
Net earnings	$ 2,148	$ 4,420	$ 3,462	$ 4,032	$ 14,062
Net earnings per share – basic	$ 0.18	$ 0.38	$ 0.30	$ 0.34	$ 1.20
Net earnings per share – diluted	$ 0.18	$ 0.38	$ 0.30	$ 0.34	$ 1.20
Average U.S. to Canadian exchange rate	$ 1.3388	$ 1.3907	$ 1.3346	$ 1.3087	$ 1.3432

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

Quarterly sales for 2020, with the exception of Quarter 1, decreased from the same quarter in 2019 due to the impact of COVID-19. Quarter 2, 2020 was the first quarter where the company saw sales declines due to the pandemic. While year-over-year there has been a decline the sales volume has increased from Quarter 2 to Quarter 4. There continues to be significant fluctuations of sales volumes in various markets, with some markets being more heavily impacted by COVID-19 than others. Sales for 2020 have been favourably impacted due to small fluctuations in exchange rates.

Gross margin rates for the fourth quarter have increased from the same quarter last year and year-to-date margins have also increased despite a slight decline in the first quarter of the same year. The margin improvement can be attributed to sales mix, market specific pricing, raw material commodity costs and cost reductions and expense containment. HPS Canadian entities received the CEWS government subsidy to partially offset additional costs related to managing COVID-19.

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

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Quarter 4, 2020 financial results

	Quarter ended December 31, 2020	Quarter ended December 31, 2019
Sales	$ 80,169	$ 90,653
Gross margin rate	28.9%	25.7%
Earnings from operations	$ 7,047	$ 5,862
Exchange loss (gain)	$ 401	$ (154)
Net earnings	$ 4,032	$ 3,211
Net earnings from continuing operations	$ 4,032	$ 3,851
Earnings per share – basic	$ 0.34	$ 0.27
Earnings per share – diluted	$ 0.34	$ 0.27
Earnings per share from continuing operations – basic	$ 0.34	$ 0.32
Earnings per share from continuing operations – diluted	$ 0.34	$ 0.32
Cash provided by operations	$ 8,073	$ 16,447

Sales for the quarter ended December 31, 2020 were $80,169, a decrease of $10,484 or 11.6% from the comparative quarter last year, which is reflective of decreased market activity due to the impact of COVID-19.

Quarter 4, 2020 gross margin dollars decreased slightly by $102 compared to Quarter 4, 2019. The gross margin rate increased to 28.9% in Quarter 4, 2020 versus 25.7% in Quarter 4, 2019 as a result of sales mix and the receipt of the CEWS government subsidy.

Total selling and distribution expenses amounted to $10,202 in Quarter 4, 2020 versus $9,924 in Quarter 4, 2019 – an increase of $278 or 2.8%. Selling and distribution expenses as a percentage of sales have increased to 12.7% in 2020 compared to 10.9% in 2019 – a result of the decline in sales.

General and administrative expenses for Quarter 4, 2020 totaled $5,950, a decrease of $1,565 when compared to Quarter 4, 2019 costs of $7,515. The prior year abnormal expected credit loss provisions primarily related to our international operations account for the current year decrease. General and administrative expenses as a percentage of sales have decreased to 7.4% in 2020 compared to 8.3% in 2019.

Quarter 4, 2020 net finance and other costs were $582 compared to $369 for the same quarter in 2019, an increase of $213 or 57.7%. The Quarter 4, 2020 interest cost decreased from $679 in Quarter 4, 2019 to $296 in Quarter 4, 2020 – a result of lower bank indebtedness levels. Foreign exchange loss in Quarter 4, 2020 was $401 compared to a foreign exchange gain of $154 in Quarter 4, 2019.

Earnings from operations for the quarter were positively impacted by lower general and administrative expenses, offset by decreased sales, less gross margin dollar contribution and higher selling and distribution expenses. Quarter 4, 2020 earnings from operations increased $1,185 from earnings of $5,862 in Quarter 4, 2019 to earnings of $7,047 in Quarter 4, 2020.

Quarter 4, 2020 income tax expense was $2,433 on earnings before income taxes of $6,465 (an effective tax rate of 37.6%) as compared to an income tax expense of $1,642 on income before income taxes of $5,493 (an effective tax rate of 29.9%) in Quarter 4, 2019 – an increase of $791.

Net earnings from continuing operations for Quarter 4, 2020 was $4,032 compared to net income of $3,851 in Quarter 4, 2019 – an improvement of $181.

Cash provided by operations for Quarter 4, 2020 was $8,073 versus $16,447 in Quarter 4, 2019 – a decrease of $8,374. A decrease in the cash generated from operations was the main driver of the lower value for the quarter. Quarter 4, 2020 had non-cash working capital usage of $825, compared to Quarter 4, 2019 were non-cash working capital generated by operations was $7,926.

Overall operating debt balance, net of cash, was $1,278 as at December 31 2020, a decrease of $8,048 as compared to a net debt balance of $9,326 as at December 31, 2019, primarily reflecting improved profitability, cash generated from operations and the receipt of the CEWS government subsidy.

Capital resources and liquidity

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

Cash provided from operating activities during 2020 was $19,683 versus $17,810 in 2019, an increase in cash generated of $1,873. This increase in cash generated from operating activities was due to higher net income. Non-cash working capital used cash of $4,992 in 2020 versus $6,374 in 2019, resulting in a decrease of $1,382 from 2019. The change in non-cash working capital for 2020 was primarily a result of decreases in accounts receivable and inventory, offset by decreases in accounts payable and foreign exchange adjustments.

Accounts receivable finished the year at $53,078 as compared to $64,004 as at December 31, 2019, a decrease of $10,926 – a result of lower sales and higher collections in Quarter 4, 2020 compared to Quarter 4, 2019. HPS' days sales outstanding ratio remains below industry standards, which can be attributed to effective credit policies and tightly managed accounts receivable administration.

Inventories finished the year at $49,206 as at December 31, 2020, versus $50,926 as at December 31, 2019, a decrease of $1,720. The higher inventory levels in 2019 were attributed to a buildup of inventory to satisfy a predicted increase in 2020 sales volume.

Accounts payable and accrued liabilities, excluding derivative liability, decreased by $10,597 finishing at $44,227 as at December 31, 2020 compared to $54,824 at the end of 2019. The change in accounts payable is related to the timing of purchases from and payments to suppliers.

Net income taxes payable were $454 (income taxes receivable of $488 less income taxes payable of $942) as at December 31, 2020, versus net income taxes receivable of $571 (income taxes receivable of $1,626 less income taxes payable of $1,055) as at December 31, 2019 – a change of $1,025 due to increased Quarter 4, 2020 earnings.

Cash used in financing activities was $24,184 in 2020, compared to cash used of $7,393 in 2019, a change of $16,791. The change in the balance can be attributed to higher repayment of bank operating lines in 2020 compared to 2019 and higher dividend payments.

Cash used in investing activities in 2020 increased $1,779 from $2,968 in 2019 to $4,747 in 2020, a result of the prior year including proceeds on disposal of Italian assets of $1,583 which offset cash outflows in this category. There was an increase in capital spending for property, plant and equipment of $540 over the prior year, totaling $4,222 in 2020 – compared to $3,682 for 2019. The Company continues to invest in the areas of manufacturing processes and capabilities as well as information technology, product and research development.

Bank operating lines of credit finished the year at $16,073 as at December 31, 2020, compared to $32,697 as at December 31, 2019 resulting in a large decrease of $16,624 in the year. The Company had cash and cash equivalent balances of $14,795 as at December 31, 2020 as compared to $23,371 as at December 31, 2019.

Overall operating debt balance, net of cash, was $1,278 as at December 31 2020, an improvement of $8,048 as compared to a net debt balance of $9,326 as at December 31, 2019, primarily reflecting improved profitability and cash generated from operations.

All bank covenants were met as at December 31, 2020, and the Company was in compliance with its covenants throughout the year.

The Company's liquidity is strong. HPS is well funded, with sufficient cash and debt capacity to fund its operating activities, investments and strategic growth initiatives. The Company has several alternatives to fund future capital requirements, including its existing cash position, credit facility, future operating cash flows and debt financing. The Company continually evaluates these options to ensure that the appropriate mix of capital resources is effectively managed for current and future requirements.

The Company has outstanding capital expenditure commitments of $1,029 primarily for manufacturing efficiency improvement projects and capacity expansion. These ongoing projects are in support of future business development and growth.

Additional details of our change in non-cash working capital can be found in note 27 in the Notes to Consolidated Financial Statements contained in our 2020 Annual Report.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Credit agreement

The Company's current credit agreement consists of a $40,000 U.S. revolving credit facility and a $10,000 U.S. delayed draw credit facility. The revolving borrowing can be comprised of U.S. Prime Borrowings, Canadian Prime Borrowings, CDOR Borrowings or LIBOR Borrowings. This agreement aligns our Canadian and U.S. banking requirements, supports our hedging strategies and provides financing for our operational requirements and capital for our strategic initiatives. The Company has access to a 4,070 EUR facility that matures in May 2021, made up of a 3,750 EUR revolver and 250 EUR overdraft facility, as well as a 70 EUR letter of credit line. Hammond Power Solutions Private Limited ("HPS India") maintains a demand credit facility of 375,000 INR, consisting of a 131,000 INR short-term working capital demand loan facility and a 244,000 INR bank guarantee and letters of credit facility.

Based on exchange rates in effect at December 31, 2020, the combined Canadian dollar equivalent available prior to any utilization of these facilities was $76,477.

The Company's current North American credit agreement matures in June 2021. The Company is currently in the process of finalizing a new 5-year agreement.

Contractual obligations

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

	2021	2022	2023	2024	2025 & Thereafter	Total
Accounts payable and accrued liabilities	$ 44,227	–	–	–	–	$ 44,227
Capital expenditure purchase commitments	1,029	–	–	–	–	1,029
Operating lines of credit	16,073	–	–	–	–	16,073
Derivative liability	1,952	–	–	–	–	1,952
Lease liabilities	2,719	2,622	1,848	1,675	1,577	10,441
Total	$ 66,000	$ 2,622	$ 1,848	$ 1,675	$ 1,577	$ 73,722

Hammond Power Solutions S.p.A. – Italy

As part of the VPI asset sale agreement, the lease agreement relating to the Meledo, Italy building includes a put and call sale option related to the leased premises, exercisable within 60 days after September 30, 2023. The call option grants the purchaser an option to purchase the premises from the Company for consideration equal to 2,225 EUR. The plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375 EUR (approximately $573). If the purchaser does not execute the call option HPS can exercise its put option which grants HPS an option to sell the plant to the purchaser for consideration equal to the same plant purchase price. If the purchaser rejects the put option, the purchaser will pay 500 EUR (approximately $764) as liquidated damages.

Contingent liabilities

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

Management is not aware of any further contingent liabilities.

Regular quarterly dividend

The Board of Directors of HPS declared a 21.4% increase in the quarterly cash dividend to eight and a half cents ($0.085) per Class A Subordinate Voting Share of HPS and of eight and a half cents ($0.085) per Class B Common Share of HPS.

The Quarter 1 dividend was paid on March 26, 2020 to shareholders of record at the close of business on March 19, 2020 – the ex-dividend date was March 18, 2020. The Quarter 2 dividend was paid on June 18, 2020 to shareholders of record at the close of business on the 11th day of June 2020 – the ex-dividend date was June 10, 2020. The dividend for Quarter 3 was paid on September 28, 2020 to shareholders of record at the close of business on September 21, 2020 – the ex-dividend date was September 18, 2020. The Quarter 4 dividend was paid on December 9, 2020 to shareholders of record at the close of business on December 2, 2020 – the ex-dividend date was December 1, 2020.

In 2020, the Company has paid a total cash dividend of thirty-four cents ($0.34) per Class A Subordinate Voting Share and thirty-four cents ($0.34) per Class B Common Share compared to 2019, the Company had paid a total cash dividend of twenty-eight cents ($0.28) per Class A Subordinate Voting Share and twenty-eight cents ($0.28) per Class B Common Share.

Controls and procedures

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

As at December 31, 2020, the Company conducted an evaluation, under the direction and supervision of the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2020 such disclosure controls and procedures were operating effectively.

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

Internal controls over financial reporting

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

Canadian Securities Administrators require that companies certify the effectiveness of internal controls over financial reporting. It also requires a company to use a control framework such as the COSO Framework to design internal controls over financial reporting. As well, the threshold for reporting a weakness of internal controls over financial reporting should be of a "material weakness" rather than "reportable deficiency." HPS has designed its internal controls in accordance with the COSO Framework and has carried out retesting in 2020, which was completed in the fourth quarter.

As of December 31, 2020 Management, with the supervision and participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting. Based on that assessment, the Chief Executive Officer and Chief Financial Officer have concluded that the internal controls are effective and that there were no material weaknesses in the Company's internal control over financial reporting as of December 31, 2020.

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

During 2020 there were no material changes identified in HPS' internal controls over financial reporting that had materially affected, or were reasonably likely to materially affect HPS' internal control over financial reporting. HPS does carry out ongoing improvements to its internal controls over financial reporting but nothing considered at a material level. .

Subsequent events

Dividends

On March 5, 2021, the Company declared a dividend of eight and a half cents ($0.085) per Class A subordinate voting shares of HPS and a quarterly cash dividend of eight and a half cents ($0.085) per Class B common shares of HPS payable on March 25, 2021 to shareholders of record at the close of business on March 18, 2021. The ex-dividend date is March 17, 2021.

Risks and uncertainties

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

Coronavirus (COVID-19 – Business Disruption/ Interruption

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

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

- Disruptions to business operations resulting from quarantines of employees, customers, suppliers and third party service providers in areas affected by the pandemic;
- Disruptions to business operations resulting from travel restrictions;
- Disruptions to business operations resulting from government mandated lockdowns;
- Uncertainty around the duration of the virus' impact;
- Change in classification of essential services, requiring HPS to shutdown operations; and
- Availability of the COVID-19 vaccine in jurisdictions where HPS operates.

Currently, COVID-19 has been, and will continue to be, a material disruption to the Company's business. Our operations in Canada, the U.S. and Mexico have been designated as "essential service" businesses. Our Indian operations were not operating from March 24, 2020 to May 2, 2020 as the government had imposed a 100% lockdown of the country, shutting down all businesses. The Company has seen significant reductions in sales in the U.S., Canadian and Indian markets. Due to the uncertainty and unpredictability of the impacts of the COVID-19 pandemic on the business operations, the uncertainty of governmental and health authorities' legislation, the full negative financial impact of the unprecedented pandemic will be not be fully known until vaccines are widely available and the economy begins to recover.

Other Business Risks

If any of the following risks were to occur they could materially adversely affect HPS' financial condition, liquidity or results of operations.

These risks include:

Market supply and demand impact on commodity prices

An area that has a definite impact on the Company's costs and earnings is the cyclical effects and unprecedented market cost pressures of both copper commodity and steel pricing in the global markets. There is a risk in the ability of recouping rapid escalating commodity costs through selling price increases expediently. This risk is mitigated through strategic supply line agreements and alliances in place with major steel suppliers to ensure adequate supply, competitive market pricing and implementing market specific selling price increases.

We may not realize all of the anticipated benefits of our acquisitions, divestitures, joint ventures or strategic initiatives, or these benefits may take longer to realize than expected.

In order to be profitable, the Company must successfully execute upon its strategic initiatives and effectively manage the resulting changes in its operations. The Company's assumptions underlying its strategic plans may be subjective, the market may react negatively to these plans, and HPS may not be able to successfully execute these plans, and even if successfully executed, its actions may not be effective or may not lead to the anticipated benefits within the expected time frame.

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

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

We sell to customers around the world and have global operations and, therefore, are subject to the risks of doing business in many countries.

We do business in a host of countries around the world. Approximately 70% of our sales were to customers outside of Canada. In addition, a number of our manufacturing operations, suppliers and employees are located in many places around the world. The future success of our business depends in large part on growth in our sales in non-Canadian markets. Our global operations are subject to numerous financial, legal and operating risks, such as political and economic instability; prevalence of corruption in certain countries; enforcement of contract and intellectual property rights and compliance with existing and future laws, regulations and policies, including those related to tariffs, investments, taxation, trade controls, product content and performance, employment and repatriation of earnings.

Our global business translates into conducting business in various currencies, all of which are subject to fluctuations.

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

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

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

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

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

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

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

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

Our industry is highly competitive.

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

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

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

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

The business practice of extending credit to customers can lead to a risk of uncollectability.
A substantial portion of the Company's accounts receivable are with customers in manufacturing sectors and are subject to credit risks normal to those industries. The Company's expansion into emerging markets increases credit risk. This risk is partially mitigated by managements credit policy under which each new customer is analysed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group's review includes external ratings, if they are available, financial statements, credit agency information, industry information and in some cases bank references. Sale limits are established for each customer and reviewed quarterly. Any sales exceeding those limits require approval from Executive management. Although the Company has historically incurred very low bad debt expense, the current economic environment conditions elevate this exposure.

Risk of Cyberattack

Globally there have been increased incidences of outside cyberattacks and viruses on companies' information infrastructure and technologies. This risk is reduced through a number of initiatives to mitigate exposure.

Off-balance sheet arrangements

The Company has no off-Balance Sheet arrangements, other than capital commitments disclosed in note 15 in the Notes to the Consolidated Financial Statements contained in our 2020 Annual Report.

Transactions with related parties

The Company had transactions with related parties in 2020, as disclosed in note 25 in the Notes to the Consolidated Financial Statements contained in our 2020 Annual Report.

Proposed transactions

The Company had no proposed transactions as at December 31, 2020. The Company continues to evaluate potential business expansion initiatives in accordance with its long-term growth strategy.

Financial instruments

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

At December 31, 2020, the Company had outstanding foreign exchange contracts in place for 17,500 EUR, $12,500 USD and 330,000 INR – which were implemented as an economic hedge against translation gains and losses on inter-company loans and $46,500 USD to economically hedge the U.S. dollar denominated accounts payable in the Canadian operations of HPS. The Company had total outstanding foreign exchange contracts in place as at December 31, 2019 for 17,200 EUR and $12,000 USD and 330,000 INR as economic hedges against translation gains and losses on inter-company loans and $52,000 USD to economically hedge the U.S. dollar denominated accounts payable in the Canadian operations.

Further details regarding the Company's financial instruments and the associated risks are disclosed in note 29 in the Notes to the Consolidated Financial Statements contained in our 2020 Annual Report.

Critical accounting estimates

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

Such assumptions and estimates are evaluated on an ongoing basis and form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

The Company conducts its annual impairment assessment of goodwill, intangible assets and property, plant and equipment in the fourth quarter of each year, which corresponds with its annual planning cycle, and whenever events or changes in circumstances indicate that the carrying amount of an asset or Cash Generating Unit (" CGU") may not be recoverable. The Company did not identify any triggering events during the course of 2020 indicating that the carrying amount of its assets and CGUs may not be recoverable, which would require the performance of an impairment test for those CGUs which did not contain goodwill.

Outstanding share data

Details of the Company's outstanding share data as of December 31, 2020, are as follows:

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

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

New accounting pronouncements

Definition of a Business (Amendments to IFRS 3)

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

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

The Company adopted the amendments in its financial statements for the annual period beginning on January 1, 2020. The adoption of the amendments did not have a material impact on the consolidated financial statements.

New accounting pronouncements to be adopted

The IASB has issued the following standards, interpretations and amendments to standards that are not yet effective, have not yet been adopted by the Company and are not expected to have a material impact on the consolidated financial statements.

The Company intends to adopt the following amendments in its financial statements for the annual period beginning on January 1, 2022:

- Property, Plant and Equipment – Proceeds before Intended Use (Amendments to IAS 16)
- Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)
- Reference to the Conceptual Framework (Amendments to IFRS 3)
- Annual Improvements to IFRS Standard 2018-2020

The Company intends to adopt the following amendment in its financial statements for the annual period beginning on January 1, 2023:

- Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)

The Company intends to adopt the following amendment once an effective date has been announced:

- Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture

Strategic direction and outlook

HPS has a rich and extensive history of growth, innovation and resilience. As an essential service HPS has always had to ensure they were ready to respond to their shareholders, customers and employees.

For our shareholders, HPS has provided:
- Escalating growth of the NAED channel;
- New global customers;
- Expanded relationships with existing customers;
- Capital investment in North American manufacturing facilities in Canada, the U.S. and Mexico;
- Establishment of a state-of-the-art core manufacturing facility in Mexico;
- Healthy gross margin rates, strong earnings per share, solid cash generation; and
- Quarterly dividends paid with an attractive yield.

For our customers, HPS has provided:
- Compliance with regulatory changes;
- New product development;
- Expanded product offering using cast resin technology;
- Superior customer service;
- Accurate ship on time; and
- Competitive pricing for our products.

For our employees, HPS has provided:
- The tools to facilitate their best work, which includes development and further implementation of our ERP system to enhance availability of information and streamline processes;
- Space and time for innovation and development;
- Safety in the workplace, especially during COVID-19; and
- Ability for remote work, where able, to help manage school closures and health concerns.

Hammond Power Solutions has a history of strength, perseverance and depth. We have navigated through difficult and fluctuating economic times, increased globalization, adapted to changes in customers and markets and have experienced significant advances in technology. Most recently HPS has steered through the COVID-19 pandemic. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes while continuing to grow and expand.

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

The COVID-19 pandemic continues to have an unprecedented impact on the global economy. The extent of the impact or timeline is still not yet known, but governmental decisions to declare a state of emergency in a number of countries in which we operate had an immediate impact on the economies of such countries. The demand for our transformers particularly in North America continues, but sales volumes have been and are expected to be, tempered due to the economic impact caused by the pandemic. Based on the foregoing, HPS expects to see continued moderation and fluctuation of revenues as well as a continuation of increases in operational costs which had the effect of reducing HPS' financial performance in 2020 and will continue to have an impact into 2021. Our Canadian entities received a government subsidy for eligible wages in Quarter 2-4, 2020 which offset some additional wages and operational COVID-19 related costs and supported operational and financial performance. The wage subsidy has been extended into 2021 and the Company will continue to monitor eligibility. HPS will remain cognizant of further programs that may be announced.

The Company has implemented robust health and safety precautions dedicated to providing a safe working environment for our employees while continuing to manufacture and serve our customers during this volatile and unpredictable time.

As an essential service, the Company has continued to remain open and producing to ensure our customers have the transformers they need to fulfill the many applications they are purchased for. HPS is committed to managing the impact the pandemic will have on our financial performance. The Company will maintain its liquidity and balance sheet strength.

The implementation of our ERP system has allowed HPS to enhance the availability and quality of information accessible to support operational performance, improve customer service, supplement strategic decision making and audit and control. The ERP system implementation is currently in progress at our operation in Granby Quebec, an implementation project which began in Quarter 1, 2020 and represents the Company's final operation that will be converted to our ERP platform. It is expected to be fully implemented by the end of Quarter 2, 2021. The consolidation to the ERP platform is an important step towards providing one global, integrated, consistent source of information and data.

HPS has modern manufacturing facilities throughout the world and this continues to be enhanced through our committed capital investment. HPS continues to focus on customer service and growth – expanding existing relationships as well as exploring new opportunities. Past regulatory requirements to comply with the U.S. Department of Energy ("DOE") regulations and the Canadian efficiency standard changes ("NRCan") have created opportunities for us to deliver energy efficient, regulatory compliant transformers fulfilling the needs of our customers. These regulation changes have resulted in new product development and manufacturing techniques.

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

While HPS has experienced a number of successes and challenges, the unpredictable and fluctuating global economic climate has had a pervasive and persistent impact on HPS' profitability over a number of years. The Company has also experienced the adverse impact of variability of raw material commodity costs, unpredictable foreign currency rates, fluctuating manufacturing throughput and market pricing pressures. Through HPS' strategic projects and operational plans these deterrents are being prudently managed.

HPS is confronting these challenges and continuously building our competitive and strategic advantage while being cognizant of the importance of our shareholders, customers and employees.

For our shareholders, HPS is focusing on:
- Disciplined cost management initiatives to ensure price competitiveness in the market;
- Cash flow generation;
- Capital investment; and
- Strategic planning.

For our customers, HPS is focusing on:
- Sales development;
- NAED channel expansion;
- Broadened product offering;
- Product development; and
- Bringing quality and value to all that we produce.

For our employees, HPS is focusing on:
- Investing in our employees, through leadership training and development programs;
- Implementing a new Human Resource information system to provide an in-house payroll system, dynamic performance evaluation module, succession planning, personal learning development and people management tool;
- Relaunch of our internal continuous improvement program, Transform, to further foster a culture of innovation; and
- Ongoing support through the CEWS wage subsidy where we qualify.

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

As an essential service, HPS will continue to deliver solid financial performance, provide a sustainable return to our shareholders, support employees well-being and growth and deliver long-term value to all stakeholders.

Selected Annual and Quarterly Information

(tabular amounts in thousands of dollars)

Annual Information (1)	2016	2017	2018	2019	**2020**
Sales	274,793	301,750	314,082	358,792	322,097
Earnings from operations	10,873	14,470	13,779	20,543	22,041
EBITDA	14,356	23,069	17,915	28,175	29,482
Net earnings (loss)	1,793	6,114	(12,917)	11,607	14,062
Total assets	205,177	192,449	205,527	214,953	189,394
Non-current liabilities	4,131	3,641	2,528	11,271	8,329
Total liabilities	84,524	77,438	96,793	105,186	75,478
Total shareholders' equity attributable to equity holders of the Company	120,441	114,848	108,734	109,767	113,916
Operating debt, net of cash	(11,318)	(16,983)	(17,056)	(9,326)	(1,278)
Cash provided by operations	15,216	1,032	6,474	17,810	19,683
Basic earnings (loss) per share	0.16	0.53	(1.10)	0.99	1.20
Diluted earnings (loss) per share	0.16	0.52	(1.10)	0.99	1.20
Dividends declared and paid	2,808	2,809	2,818	3,287	3,993
Average exchange rate (USD$=CAD$)	1.325	1.298	1.294	1.327	1.343
Book value per share	10.29	9.80	9.26	9.36	9.70

	2019				**2020**			
Quarterly Information	Q1	Q2	Q3	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Sales	84,690	91,937	91,502	90,653	88,420	75,393	78,115	80,169
Earnings from operations	4,479	4,731	5,471	5,862	3,033	6,514	5,447	7,047
EBITDA	6,111	7,111	7,302	7,651	5,678	8,447	7,466	7,891
Net earnings	2,508	3,352	3,595	2,152	2,148	4,420	3,462	4,032
Total assets	206,554	205,059	206,586	214,953	212,929	197,895	203,443	189,394
Non-current liabilities	10,914	10,558	9,947	11,271	9,729	9,039	8,558	8,329
Total liabilities	99,939	99,640	96,870	105,186	97,156	81,375	87,215	75,478
Total shareholders' equity attributable to equity holders of the Company	106,615	105,419	109,716	109,767	115,773	116,520	116,228	113,916
Operating debt, net of cash	(16,588)	(18,582)	(22,678)	(9,326)	(18,356)	(12,906)	(4,790)	(1,278)
Cash (used) provided by operations	2,316	507	(1,460)	16,447	(6,038)	7,229	10,419	8,073
Basic earnings per share	0.20	0.25	0.27	0.27	0.18	0.38	0.30	0.34
Diluted earnings per share	0.20	0.25	0.27	0.27	0.18	0.38	0.30	0.34
Dividends declared and paid	822	821	821	823	998	999	998	998
Average exchange rate (USD$=CAD$)	1.330	1.338	1.320	1.320	1.339	1.391	1.335	1.309
Book value per share	9.09	8.99	9.33	9.36	9.86	9.92	9.90	9.70

(1) Balances for 2016 – 2017 not restated to reflect discontinued operations

Management's Responsibility for Financial Statements

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

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

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

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

WGH

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

Christopher R. Huether
Corporate Secretary
& Chief Financial Officer

March 25, 2021

To the Shareholders of Hammond Power Solutions Inc.

Opinion

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

- the consolidated statements of financial position as at end of December 31, 2020 and end of December 31, 2019
- the consolidated statements of operations for the years then ended
- the consolidated statements of comprehensive income (loss) for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as December 31, 2020 and December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

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

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our auditors' report.

Evaluation of the carrying value of goodwill for the India cash generating unit

Description of the matter

We draw attention to Notes 2(d)(ii), 3(g) and 12 of the financial statements. The goodwill balance is $10,908 thousand, of which, $8,728 thousand relates to the Hammond Power Solutions Private Limited ("India") cash generating unit ("CGU"). The Entity conducts its annual impairment assessment of goodwill on an annual basis or whenever events or changes in circumstances indicate that the carrying amount of a CGU may not be recoverable. Performing impairment testing requires management to determine the estimated recoverable amount of the relevant cash-generating units on the basis of projected future cash flows. The determination of the recoverable amount requires management to make significant estimates and assumptions which include projected revenue, projected gross margin rates, terminal growth rates, and the discount rate.

Why the matter is a key audit matter

We identified the evaluation of the goodwill impairment analysis for the India CGU as a key audit matter. The estimated recoverable amount of the India CGU approximated its carrying value. This indicated a significant risk of misstatement as changes to certain significant assumptions had a significant effect on the recoverable amount of the India CGU. As a result, significant auditor judgment was required in evaluating the results of the audit procedures.

How the matter was addressed in the audit

The following are the primary procedures we performed to address this key audit matter:

- We compared the Entity's historical projected revenue and projected gross margin rates to actual results to assess the Entity's ability to accurately project revenue and gross margin rates.
- We performed sensitivity analyses over the projected revenue and discount rate assumptions to assess their impact on the Entity's determination that the estimated recoverable amount of the CGU exceeded its carrying value.
- We evaluated the terminal growth rate by comparing to overall market and industry conditions and overall macro-economic conditions.
- We involved valuation professionals with specialized skills and knowledge, who assisted in evaluating the appropriateness of the discount rate assumption used in the estimated recoverable amount, by comparing it to a discount rate range that was independently developed using publicly available information and considering risks specific to the CGU.

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 "Annual Report 2020".

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

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

We obtained the information included in Management's Discussion and Analysis and the Annual Report 2020 filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with 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.

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Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

We also:

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

KPMG LLP

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

March 25, 2021
Waterloo, Canada

Consolidated Statements of Financial Position

(in thousands of dollars)

	As at	
	December 31, 2020	December 31, 2019
Current assets		
Cash and cash equivalents	$ 14,795	$ 23,371
Accounts receivable (note 4)	53,078	64,004
Inventories (note 5)	49,206	50,926
Income taxes receivable	488	1,626
Prepaid expenses and other assets (note 6)	2,687	2,657
Total current assets	120,254	142,584
Non-current assets		
Long-term lease and note receivable (note 7)	3,201	3,180
Property, plant and equipment (note 8)	30,372	32,468
Investment in properties (note 9)	3,649	3,709
Investment in joint venture (note 10)	13,300	13,428
Deferred tax assets (note 16)	1,809	1,944
Intangible assets (note 11)	5,901	6,331
Goodwill (note 12)	10,908	11,309
Total non-current assets	69,140	72,369
Total assets	$ 189,394	$ 214,953
Liabilities		
Current liabilities		
Bank operating lines of credit (note 13)	$ 16,073	$ 32,697
Accounts payable and accrued liabilities (notes 17 and 29)	46,179	56,216
Income taxes payable	942	1,055
Provisions (note 20)	1,811	1,710
Current portion of lease liabilities (note 14)	2,144	2,237
Total current liabilities	$ 67,149	$ 93,915
Non-current liabilities		
Provisions (note 20)	317	285
Deferred tax liabilities (note 16)	836	1,819
Long-term portion of lease liabilities (note 14)	7,176	9,167
Total non-current liabilities	8,329	11,271
Total liabilities	$ 75,478	$ 105,186
Shareholders' Equity		
Share capital (note 17)	14,491	14,491
Contributed surplus	2,498	2,498
Accumulated other comprehensive income	1,519	7,439
Retained earnings	95,408	85,339
Total shareholder's equity	113,916	109,767
Commitments (note 15)		
Subsequent events (note 32)		
Total liabilities and shareholders' equity	$ 189,394	$ 214,953

See accompanying Notes to Consolidated Financial Statements.

On behalf of the Board:

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

David J. FitzGibbon
Chairman Audit Committee

Consolidated Statements of Operations

Years ended December 31, 2020 and 2019 (in thousands of dollars except for per share)

	2020	2019
Sales (note 21)	$ 322,097	$ 358,782
Cost of sales (note 5 and note 22)	235,103	270,823
Gross margin	86,994	87,959
Selling and distribution (note 22)	40,217	41,476
General and administrative (note 22)	24,736	25,940
	$ 64,953	$ 67,416
Earnings from operations	22,041	20,543
Finance and other costs		
Interest expense	1,247	1,739
Foreign exchange gain	(123)	(234)
Share of income of investment in joint venture, net of tax (note 10)	(153)	(267)
Other	104	117
Net finance and other costs	1,075	1,355
Earnings before income taxes	20,966	19,188
Income tax expense (recovery) (note 16):		
Current	7,827	6,425
Deferred	(923)	(543)
	6,904	5,882
Net earnings from continuing operations	$ 14,062	$ 13,306
Loss from discontinued operations, net of tax (note 23)	–	(1,699)
Net earnings	14,062	11,607
Earnings per share (note 18)		
Basic earnings per share	$ 1.20	$ 0.99
Diluted earnings per share	$ 1.20	$ 0.99
Basic earnings per share from continuing operations	$ 1.20	$ 1.13
Diluted earnings per share from continuing operations	$ 1.20	$ 1.13

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income

Years ended December 31, 2020 and 2019 (in thousands of dollars)

	2020	2019
Net earnings	$ 14,062	$ 11,607
Other comprehensive loss		
Items that will be recognized within profit and loss:		
Foreign currency translation differences for foreign operations	(5,920)	(7,456)
Foreign currency translation differences for discontinued operations	–	2,155
Other comprehensive loss, net of income tax	(5,920)	(5,301)
Total comprehensive income	$ 8,142	$ 6,306

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Years ended December 31, 2020 and 2019 (in thousands of dollars)

	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
Balance as at January 1, 2019	$ 14,217	$ 2,559	$ 12,740	$ 77,258	$ 106,774
Total comprehensive income for the period					
Net income	–	–	–	11,607	11,607
Other comprehensive loss					
Foreign currency translation differences related to joint venture	–	–	(869)	–	(869)
Foreign currency translation differences	–	–	(4,432)	–	(4,432)
Total other comprehensive loss	–	–	(5,301)	–	(5,301)
Total comprehensive income for the period	–	–	(5,301)	11,607	6,306
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 17)	–	–	–	(3,287)	(3,287)
Stock options exercised (note 17)	339	(49)	–	–	290
Repurchase of shares (note 17)	(65)	(12)	–	(239)	(316)
Total transactions with owners	274	(61)	–	(3,526)	(3,313)
Balance at December 31, 2019	$ 14,491	$ 2,498	$ 7,439	$ 85,339	$ 109,767
Balance at January 1, 2020	$ 14,491	$ 2,498	$ 7,439	$ 85,339	$ 109,767
Total comprehensive income for the period					
Net income	–	–	–	14,062	14,062
Other comprehensive loss					
Foreign currency translation differences related to joint venture (note 10)	–	–	(281)	–	(281)
Foreign currency translation differences	–	–	(5,639)	–	(5,639)
Total other comprehensive loss	–	–	(5,920)	–	(5,920)
Total comprehensive income for the period	–	–	(5,920)	14,062	8,142
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 17)	–	–	–	(3,993)	(3,993)
Total transactions with owners	–	–	–	(3,993)	(3,993)
Balance at December 31, 2020	$ 14,491	$ 2,498	$ 1,519	$ 95,408	$ 113,916

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

Consolidated Statements of Cash Flows

Years ended December 31, 2020 and 2019 (in thousands of dollars)

		2020		2019
Cash flows from operating activities				
Net earnings	$	14,062	$	11,607
Adjustments for:				
Share of income of investment in joint venture		(153)		(267)
Depreciation of property, plant and equipment and right-of-use assets		6,233		6,151
Amortization of intangible assets		1,036		1,097
Gain on disposal of right to use asset		(10)		–
Provisions		1,080		(132)
Interest expense		1,247		1,745
Loss on disposition (note 23)		–		687
Income tax expense		6,904		5,882
Unrealized loss on derivatives		560		2,997
Share-based compensation expense		518		364
		31,477		30,131
Change in non-cash working capital (note 27)		(4,992)		(6,374)
Cash generated from operating activities		26,485		23,757
Income tax paid		(6,802)		(5,947)
Net cash provided from operating activities		19,683		17,810
Cash flows from investing activities				
Investment in joint venture (note 10)		–		(728)
Proceeds on disposal of property, plant and equipment		–		1,583
Repayment of note and lease receivable		188		182
Acquisition of property, plant and equipment		(4,222)		(3,682)
Acquisition of intangible assets		(713)		(323)
Cash used in investing activities		(4,747)		(2,968)
Cash flows from financing activities				
Proceeds from issue of share capital		–		290
Cash dividends paid		(3,993)		(3,287)
Net (repayments) advances of bank operating lines of credit		(16,624)		96
Share repurchase (note 17)		–		(316)
Interest paid		(917)		(1,745)
Payment of lease liabilities (note 14)		(2,650)		(2,431)
Cash used in financing activities		(24,184)		(7,393)
Foreign exchange on cash and cash equivalents held in a foreign currency		672		377
(Decrease) increase in cash and cash equivalents		(8,576)		7,826
Cash and cash equivalents at beginning of period		23,371		15,545
Cash and cash equivalents at end of period	$	14,795	$	23,371

For the years ended December 31, 2020 and 2019 (tabular amounts in thousands of dollars, except share and per share amounts)

1. Reporting entity

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

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

2. Basis of preparation

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”), and were approved by the Board of Directors on March 25, 2021.

(b) Basis of measurement

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

(c) Functional and presentation currency

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

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

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

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

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

(d) Use of estimates and judgments

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

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

(i) Critical judgments in applying accounting policies

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

Cash generating units

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

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

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

Initial lease term

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

Operating segments

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

(ii) Key sources of estimation uncertainty

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

For the years ended December 31, 2020 and 2019 (tabular amounts in thousands of dollars, except share and per share amounts)

Recoverability of goodwill and intangible assets

The Group tests annually or more frequently if necessary, whether goodwill or other long-lived assets have suffered any impairment in accordance with the accounting policy provided in note 3(k). Performing impairment testing requires management to determine the estimated recoverable amount of the relevant cash-generating units on the basis of projected future cash flows using internal business plans or forecasts, and discounting these cash flows to appropriately reflect the time value of money.

The key assumptions made by management in deriving the recoverable amount are i) projected revenue, ii) projected gross margin rates, iii) terminal growth rates, and iv) the discount rate.

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

For assumptions relating to impairment testing, refer to note 12.

Provisions for warranty claims

The Group records a provision for warranties based on historical warranty claim information and anticipated warranty claims, based on a weighted probability of possible outcomes.

The key assumptions made by management in recording the provision are i) warranty cost, ii) probability of claim, and iii) quantum of units which may be subject to any warranty claim.

Quantifying provisions inherently involves judgement, and future events and conditions may impact these assumptions. Differences in actual future experience from the assumptions utilized may result in a greater or lower warranty cost. For further information on the Group's provisions, refer to note 20.

3. Summary of significant accounting policies:

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

(a) Basis of consolidation

The consolidated financial statements include the accounts of Hammond Power Solutions Inc. and its wholly-owned subsidiaries, Hammond Power Solutions, Inc., Hammond Power Solutions, S.A. de C.V., Delta Transformers Inc., Hammond Power Solutions Private Limited., Continental Transformers s.r.l., and its wholly-owned subsidiary, Hammond Power Solutions S.p.A.

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

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

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

For the years ended December 31, 2020 and 2019 (tabular amounts in thousands of dollars, except share and per share amounts)

(b) Financial instruments

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

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

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

The Group has applied the following classifications:

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

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

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

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

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

(c) Cash and cash equivalents

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

(d) Property, plant and equipment

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

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

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

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

- Buildings 14-30 years
- Leaseholds and improvements lesser of 5 years and lease term
- Machinery and equipment 4-10 years
- Office equipment 4-10 years
- Land is not depreciated

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

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

(e) Intangible assets other than goodwill

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

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

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

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

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

(f) Research and development expenses

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

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

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(g) Goodwill

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

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

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

An impairment loss in respect of goodwill is never subsequently reversed. The Group completed its annual goodwill impairment tests at December 31, 2020.

(h) Investment property

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

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

(i) Joint Venture

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

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

(j) Inventories

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

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

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

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

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

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

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

(l) Share-based payment transactions

Stock Option Plan

The Group has a stock-based compensation plan, which is described in note 17. The Group accounts for all stock-based payments using the fair value based method.

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

Deferred Share Unit Plan

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

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

(m) Provisions

Provisions comprise liabilities of uncertain timing or amounts that arise from restructuring plans, environmental, litigation, commercial or other risks. Provisions are recognized when there exists a legal or constructive obligation stemming from a past event and when the future cash outflows can be reliably estimated. A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities. A restructuring provision relating to a sale or termination of a line of business, the closure of business locations in a country or region, changes in management structure or fundamental reorganizations that have a material effect of the nature or focus of the Group's operations are recognized when the Group has a detailed, formal plan for the restructuring that identifies:

- the business or part of a business concerned;

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- the principal locations affected;
- the location, function and approximate number of employees affected;
- the expenditures that will be undertaken; and
- when the plan will be implanted.

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

(n) Revenue

The Group recognizes revenue using a 5-step approach:

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

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

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

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

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

(o) Income taxes

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

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

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(p) Employee benefits

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

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

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

(q) Finance income and finance costs

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

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

(r) Earnings per share

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

(s) Leases

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

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate. The group applies a single discount rate to the portfolio of leases with reasonably similar characteristics.

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

The Group does not recognize right-of-use assets and lease liabilities for contracts that have a lease term of 12 months or less or are low-value assets (under $5,000).

(t) Government assistance

The Group recognizes government assistance in the statement of operations on a systematic basis over the periods in which the entity recognises expenses for the related costs for which the assistance is intended to compensate.

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(u) New accounting pronouncements adopted during the period

Definition of a Business (Amendments to IFRS 3)

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

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

The Company adopted the amendments in its financial statements for the annual period beginning on January 1, 2020. The adoption of the amendments did not have a material impact on the consolidated financial statements.

(v) New accounting pronouncements

The International Accounting Standards Board has issued the following Standards, Interpretations and Amendments to Standards that are not yet effective, have not yet been adopted by the Group and are not expected to have a material impact on the consolidated financial statements.

The Group intends to adopt the following amendments in its financial statements for the annual period beginning on January 1, 2022:

- Property, Plant and Equipment – Proceeds before Intended Use (Amendments to IAS 16)
- Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)
- Reference to the Conceptual Framework (Amendments to IFRS 3)
- Annual Improvements to IFRS Standard 2018-2020

The Group intends to adopt the following amendment in its financial statements for the annual period beginning on January 1, 2023:

- Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)

The Group intends to adopt the following amendment once an effective date has been announced:

- Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture

4. Accounts receivable

	December 31, 2020	December 31, 2019
Trade accounts receivable	$ 49,129	$ 60,589
Other receivables	3,949	3,415
	$ 53,078	$ 64,004

Trade accounts receivable is presented net of expected credit losses of $2,577,000 (December 31, 2019 – $2,997,000).

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

	December 31, 2020	December 31, 2019
Opening balance	$ 2,997	$ 2,481
Additional allowances	494	379
Writeoffs	(25)	(116)
Adjustments	(889)	253
	$ 2,577	$ 2,997

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5. Inventories

	December 31, 2020		December 31, 2019	
Raw materials	$	19,002	$	20,974
Work in progress		1,867		2,276
Finished goods		28,337		27,676
	$	49,206	$	50,926

Raw materials and changes in finished goods, and work in progress recognized as cost of sales during the year amounted to $234,395,000 (2019 – $271,475,000), of which $nil (2019 – $1,461,000) is included in discontinued operations. In addition, during the year, reversal of write-downs in the amount of $4,000 were recognized (2019 – $24,000). Inventories carried at net realisable value as at December 31, 2020 were $821,000 (December 31, 2019 – $1,190,000).

6. Prepaid and other assets

	December 31, 2020		December 31, 2019	
Prepaid expenses	$	2,455	$	2,440
Current portion of long-term lease and note receivable (note 7)		232		217
	$	2,687	$	2,657

7. Long-term lease and note receivable

On October 31, 2017, the Group sold the assets and disposed of certain liabilities of its Vacuum Pressure Impregnated (VPI) transformers product line located in Italy. Consideration due to the Group in connection with the transaction included a note receivable in the amount of 1,158,000 Euros (approximately $1,687,000).

Concurrent with the disposal of the VPI product line, the Group entered into a lease agreement ("agreement") for one of its manufacturing facilities in Italy, under which the purchaser will have the use of the plant, which includes both the land and the building, to 2023. Consideration was in the form of a lease receivable, which the Company has determined meets the definition of a finance lease.

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

In fiscal 2018, the Group recorded a provision for amounts outstanding in respect of the note receivable, as the purchaser had ceased making payments and was disputing the value of certain of the acquired assets, amongst other matters.

In October 2020, the dispute with the purchase was resolved and the note receivable was settled in the amount of 614,000 Euros (approximately $956,000). As a result, 614,000 Euros of the allowance for doubtful accounts was reversed and recorded as a recovery in the statement of earnings in general and administrative expenses.

Put and call option

The lease agreement includes a put and call option related to the leased premises, exercisable within 60 days after September 30, 2023. The call option grants the purchaser an option to purchase the premises for consideration equal to 2,225,000 Euros (approximately $3,400,000). The put option grants HPS an option to sell the plant to the purchaser for consideration equal to the initial plant purchase price of 2,225,000 Euros. Under both the call and put option the plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375,000

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Euros (approximately $573,000). If the purchaser fails to execute the put option, the purchaser will pay 500,000 Euros (approximately $764,000) in damages. The put and call options expire November 23, 2023.

As at December 31, 2019 consideration receivable consists of:

	December 31, 2020	December 31, 2019
Lease receivable of 2,208 EUR (2019 – 2,332 EUR), with monthly lease payments of 13 EUR, bearing interest of 1.15% per annum. Gross cash entitlement:	$ 3,538	$ 3,538
Less: unearned finance income	(105)	(141)
Net lease receivable	3,433	3,397
(2019 - Note receivable of 1,158 EUR, repayment schedule of 1,158 due immediately non-interest bearing, secured by the property, plant and equipment of the VPI business)	–	1,687
Less: allowance for doubtful accounts	–	(1,687)
	$ 3,433	$ 3,397
Less: current portion included within prepaid and other assets	232	217
	$ 3,201	$ 3,180

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

2021	232
2022	232
2023	2,969
	$ 3,433

8. Property, plant and equipment

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

	December 31, 2020	December 31, 2019
Property, plant and equipment owned	$ 23,648	$ 23,415
Right-of-use assets (note 14)	6,724	9,053
	$ 30,372	$ 32,468

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	Land	Building	Leaseholds & Improvements	Machinery & Equipment	Office Equipment	Construction In Progress & Deposits	Total
Cost							
Balance at January 1, 2019	$ 4,892	$ 21,207	$ 1,520	$ 58,958	$ 10,972	$ 276	$ 97,825
Additions	–	140	95	2,089	511	847	3,682
Disposals	–	–	–	(7,513)	(19)	–	(7,532)
Transfer to investment property (note 9)	(583)	(3,179)	–	–	–	–	(3,762)
Effect of movements in exchange rates	(77)	(444)	(33)	(506)	(389)	–	(1,449)
Balance at December 31, 2019	$ 4,232	$ 17,724	$ 1,582	$53,028	$ 11,075	$ 1,123	$ 88,764
Balance at January 1, 2020	$ 4,232	$ 17,724	$ 1,582	$ 53,028	$ 11,075	$ 1,123	$ 88,764
Additions	–	301	325	1,612	489	1,495	4,222
Effect of movements in exchange rates	(22)	(46)	(107)	(574)	(106)	–	(855)
Balance at December 31, 2020	$ 4,210	$ 17,979	$ 1,800	$54,066	$ 11,458	$ 2,618	$ 92,131
Accumulated Depreciation							
Balance at January 1, 2019	$ –	$ 11,569	$ 1,317	$ 46,095	$ 9,806	$ –	$ 68,787
Depreciation for the year	–	969	103	2,777	435	–	4,284
Disposals	–	–	(257)	(5,974)	(45)	–	(6,276)
Transfer to investment property (note 9)	–	(1,097)	–	–	–	–	(1,097)
Effect of movements in exchange rates	–	(91)	(30)	(62)	(166)	–	(349)
Balance at December 31, 2019	$ –	$ 11,350	$ 1,133	$ 42,836	$ 10,030	$ –	$ 65,349
Balance at January 1, 2020	$ –	$ 11,350	$ 1,133	$ 42,836	$ 10,030	$ –	$ 65,349
Depreciation for the year	–	779	106	2,456	416	–	3,757
Effect of movements in exchange rates	–	(19)	(80)	(444)	(80)	–	(623)
Balance at December 31, 2020	$ –	$ 12,110	$ 1,159	$ 44,848	$ 10,366	$ –	$ 68,483
Carrying amounts							
At December 31, 2019	$ 4,232	$ 6,374	$ 449	$ 10,192	$ 1,045	$ 1,123	$ 23,415
At December 31, 2020	$ 4,210	$ 5,869	$ 641	$ 9,218	$ 1,092	$ 2,618	$ 23,648

Depreciation is recorded in the statement of earnings as follows: cost of sales $3,430,000 (2019 – $3,357,000), selling and distribution $5,000 (2019 – $5,000), general and administrative $322,000 (2019 – $319,000) and discontinued operations $Nil (2019 – $603,000).

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9. Investment in properties

	December 31, 2020	December 31, 2019
Glen Ewing Property	$ 1,044	$ 1,044
Marnate Property (net of accumulated depreciation of $942 (2019 - $706))	2,605	2,665
	$ 3,649	$ 3,709

Glen Ewing Property

The Group has a 50% ownership interest in a property in Georgetown, Ontario, (referred to as the Glen Ewing Property). It is a vacant plot of land currently under environmental remediation, and no revenue was derived from it in 2020 or 2019. The property is carried at cost. The estimated fair value of the property as at December 31, 2020 is $1,150,000 (2019 – $1,150,000). The fair value was determined based on independent available market evidence, with reference to comparable market transactions. The Group's share of ongoing legal, consulting and remediation costs during the year was $121,000 (2019 – $109,000).

Marnate Property

The Group owns a property in Marnate, Italy, (referred to as the Marnate Property). As part of the sale transaction of certain of the assets and liabilities of the Italian company, as outlined in note 23, the purchaser has leased the Marnate Property for a period of six years at an annual rental amount of 90,000 EUR (approximately $137,000). The operating expenses for this property were 202,000 EUR (approximately $307,000) in 2020. In 2019, concurrent with the change in use of the property, the Company reclassified it from an item of property, plant and equipment to an investment property. Depreciation on the facility was recorded in the statement of earnings as general and administrative expenses in the amount of $236,000. The estimated fair value of the property as at December 31, 2020 is 2,280,000 Euros (approximately $3,544,000). The fair value was determined based on independent available market evidence, based on comparable property sales, by an independent valuator.

10. Investment in joint venture

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

	December 31, 2020	December 31, 2019
Cost of investment in joint venture	$ 20,023	$ 20,023
Cumulative share of loss in investment in joint venture, net of tax	(3,233)	(3,386)
Foreign currency translation differences related to the joint venture	(3,490)	(3,209)
	$ 13,300	$ 13,428

During the year the Company made an additional contribution of $nil (2019 – $728,000) and recognized its share of the income of $153,000 (2019 – $267,000).

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Selected financial information relating to Corefficient is as follows:

	December 31, 2020	December 31, 2019
Cash	$ 3,553	$ 4,341
Trade and other receivables	8,155	11,286
Inventories	2,932	3,047
Other current assets	89	118
Total current assets	$ 14,729	$ 18,792
Non-current assets	16,425	19,697
Total assets	$ 31,154	$ 38,489
Current liabilities	$ 6,508	$ 12,744
Non-current liabilities	746	1,603
Total liabilities	$ 7,254	$ 14,347

	2020	2019
Revenue	$ 56,605	$ 58,423
Income for the year	278	485

Net income for the year ended December 31, 2020 includes depreciation and amortization expense of $3,118,000 (2019 – $2,149,000), net interest expense of $62,000 (2019 – $66,000) and an income tax expense of $nil (2019 – $3,000) related to Corefficient.

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11. Intangible assets and goodwill

Intangible assets	Technology	Customer lists relationships and branding	Externally acquired software	Total
Cost				
Balance at January 1, 2019	$ 6,600	$ 8,957	$ 6,416	$ 21,973
Additions	–	–	323	323
Effect of movements in exchange rates	(359)	(211)	(49)	(619)
Balance at December 31, 2019	$ 6,241	$ 8,746	$ 6,690	$ 21,677
Balance at January 1, 2020	$ 6,241	$ 8,746	$ 6,690	$ 21,677
Additions	–	–	713	713
Effect of movements in exchange rates	(122)	(87)	35	(174)
Balance at December 31, 2020	$ 6,119	$ 8,659	$ 7,438	$ 22,216
Accumulated Amortization				
Balance at January 1, 2019	$ 4,631	$ 6,404	$ 3,628	$ 14,663
Amortization for the year	145	487	465	1,097
Effect of movements in exchange rates	(231)	(141)	(42)	(414)
Balance at December 31, 2019	$ 4,545	$ 6,750	$ 4,051	$ 15,346
Balance at January 1, 2020	$ 4,545	$ 6,750	$ 4,051	$ 15,346
Amortization for the year	138	481	417	1,036
Effect of movements in exchange rates	(53)	(50)	36	(67)
Balance at December 31, 2020	$ 4,630	$ 7,181	$ 4,504	$ 16,315
Balance at				
At December 31, 2019	$ 1,696	$ 1,996	$ 2,639	$ 6,331
At December 31, 2020	$ 1,489	$ 1,478	$ 2,934	$ 5,901

Amortization of $342,000 (2019 – $347,000) has been recognized in cost of sales, $131,000 (2019 – $137,000) has been recognized in selling and distribution, $563,000 (2019 – $549,000) has been recognized in general and administrative and $nil (2019 – $64,000) has been recorded within discontinued operations.

None of the intangible assets has been internally developed.

Research and development expenses of $704,000 (2019 – $785,000) have been recognized in cost of sales in the consolidated statements of earnings. No research and development costs have been capitalized (2019 – $nil).

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12. Goodwill and impairment testing for cash-generating units

Goodwill	December 31, 2020	December 31, 2019
Opening balance	$ 11,309	$ 11,961
Effect of movements of exchange rates	(401)	(652)
Ending balance	$ 10,908	$ 11,309

The Company conducts its annual impairment assessment of goodwill, intangible assets and property, plant and equipment in the fourth quarter of each year, which corresponds with its annual planning cycle, and whenever events or changes in circumstances indicate that the carrying amount of an asset or CGU may not be recoverable. The Company did not identify any triggering events during the course of 2020 indicating that the carrying amount of its assets and CGUs may not be recoverable, which would require the performance of an impairment test for those CGUs which did not contain goodwill.

Impairment testing for cash-generating units containing goodwill

The Company has two subsidiaries identified as CGUs that contain goodwill. The CGUs and their respective goodwill balances are as follows: Delta Transformers Inc. ("Delta") $2,180,000 (2019 – $2,180,000) and Hammond Power Solutions Private Limited ("India") $8,728,000 (2019 – $9,129,000).

For its 2020 annual impairment assessment of CGUs containing goodwill, the Company used cash flow projections based primarily on its business plan for the following year, and projections for the ensuing four year period. The Company's business plan is primarily based on financial projections submitted by its subsidiaries in the fourth quarter of each year, together with inputs from customer teams. This plan is subjected to reviews by various levels of management as part of its annual planning cycle, and is approved by the Board of Directors. The values used in the cash flow projections are based on historical sales, internal growth rate assumptions, and available market data.

Based on these projections, a five year cash flow forecast was completed and discounted to present-value using discount rates specific to each CGU ranging from 12.3% – 21.9% (2019 –12.5% - 20.8%) depending on the location of the CGU. Through the five year cash flow projections, the Company's model also incorporated year 1 sales growth rates in the range of 4.7% – 80.3%, which reflects returning to normal production levels post COVID-19 pandemic as well as manufacturing of a new product line in India. The annual sales growth rates for year 2 to year 5 are in the range of 2.4% – 39.2% (2019 – year 1 to year 5 – 1.4% – 52.6%) depending on location, the CGUs operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using terminal growth rates ranging from 2% – 8% (2019 – 2% – 8%), depending on the geography of the manufacturing unit. This was then compared to the carrying value of the CGU to determine if there was impairment.

Management's approach to determining projected revenue includes consideration of current bookings, committed product line expansions (for which no additional capital expenditure is required), consultation with its salesforce and historical results. The Company's process for determining projected gross margin rates includes consideration of current pricing information from suppliers and historical gross margin rates realized by the Company. The Company determines the terminal growth rate with reference to published economic data pertaining to the applicable industry and country in which the cash generating unit operates. The discount rate is determined with reference to the cash generating unit's weighted average cost of capital.

While management believes that estimates of future cash flows and discount rates are reasonable, different assumptions regarding future cash flows or discount rates could materially affect the outcome of the impairment

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test. Management believes that certain reasonable possible changes in the key assumptions on which the recoverable amounts are based could cause the carrying amount to exceed the recoverable amount in the India CGU. As of December 31, 2020, a discount rate increase of 2.1% or a 3.5% lower terminal growth rate than the assumptions utilized would cause the estimated recoverable amount to be equal to the carrying amount for this CGU.

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

Upon completion of the 2020 annual impairment assessment of goodwill it was determined that the recoverable amount of the CGUs exceeded their respective carrying values and no impairment existed at December 31, 2020.

13. Bank operating lines of credit

The Group's North American current banking agreement, which expires in June 2021, consists of a $40,000,000 U.S. revolving credit facility and a $10,000,000 U.S. delayed draw credit facility. The revolving credit facility can be drawn in of U.S. Prime borrowings, Canadian Prime borrowings, Canadian Dollar Offered Rate ("CDOR") borrowings or London Inter-Bank Offered rate ("LIBOR") borrowings. The delayed draw facility does not charge any fees on the unutilized balance. The use of the delayed draw facility needs to be approved by the bank. The draw is available in a minimum of two tranches of $5,000,000 U.S. each. The facilities are unsecured.

The delayed draw credit facility was unutilized at December 31, 2020 and December 31, 2019. Under the terms of the facility, the Group pays a commitment fee at rates ranging from 0.30% to 0.40% payable quarterly in arrears, on the daily amount of the unused portion of the revolving North American commitment.

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

The Group also has a 4,070,000 unsecured Euro facility that matures May 2021 and may be renewed in writing each year to extend the maturity date for the facility for a further 365 days, subject to approval from the lender. The facility is comprised of a 3,750,000 Euro revolver and 250,000 Euro overdraft facility, as well as a 70,000 Euro letter of credit line. The revolver facility bears interest at Euro Interbank Offered Rate ("Euribor") plus margin of 2.25% (2019 – plus margin of 1.75%, Euribor on December 31, 2020 – 0.499%, Euribor on December 31, 2019 – 0.249%).

Hammond Power Solutions Private Limited maintains an additional demand credit facility for an unsecured working capital loan up to 375,000,000 INR (2019 – 375,000,000 INR) consisting of the sub-facilities of a 131,000,000 INR (2019 – 131,000,000 INR) short-term working capital demand loan, a 244,000,000 INR (2019 – 244,000,000 INR) facility for bank guarantees. The demand loan bears interest at a MCLR + 2.5% and the bank guarantees are at a rate of 1.0%. As at December 31, 2020, there was $nil Canadian dollar equivalent of Rupees drawn against the working capital demand loan (2019 – $nil). At December 31, 2020 there was nil INR (2019 – nil INR) drawings against the bank guarantees.

Based on exchange rates in effect at December 31, 2020, the combined Canadian dollar equivalent available across all facilities, prior to any utilization of the facilities was $76,477,000 (2019 – $77,737,000).

As at December 31, 2020, the Canadian dollar equivalent outstanding under the U.S. dollar revolving credit line was $11,215,000, consisting of $7,577,000 Canadian dollars drawn and $3,638,000 U.S. dollars drawn (2019 – $28,145,000 – consisting of $17,546,000 Canadian dollars drawn and $10,599,000 U.S. dollars drawn). As well, $4,858,000 (2019 – $4,552,000) Canadian dollar equivalent of Euros was outstanding under the Euro facility, and $nil (2019 – $nil) Canadian dollar equivalent of Indian rupees under the Rupee facility. Amounts drawn on the facility have been recognized as current liabilities based on the Company's anticipated repayment plans.

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14. Lease assets and liabilities

Lease assets

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

		Buildings		Vehicles		Office Equipment		Total
Balance at January 1, 2019	$	8,539	$	470	$	49	$	9,058
Additions		1,471		366		–		1,837
Depreciation		(1,529)		(315)		(23)		(1,867)
Effect of movement in exchange rates		22		2		1		25
Balance at December 31, 2019	$	8,503	$	523	$	27	$	9,053
Balance at January 1, 2020	$	8,503	$	523	$	27	$	9,053
Additions		–		343		–		343
Disposals		–		(15)		–		(15)
Depreciation		(1,909)		(313)		(18)		(2,240)
Effect of movement in exchange rates		(407)		(9)		(1)		(417)
Balance at December 31, 2020	$	6,187	$	529	$	8	$	6,724

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

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Lease liabilities

Maturity analysis – contractual undiscounted cash flows	**December 31, 2020**	**December 31, 2019**
Less than one year	$ 2,719	$ 2,602
One to five years	7,017	9,318
More than five years	705	696
Total undiscounted lease liabilities	$ 10,441	$ 12,616
Less: effect of discounting	$ (1,121)	$ (1,212)
Lease liabilities included in the statement of financial position	$ 9,320	$ 11,404
Current	$ 2,144	$ 2,237
Non-current	$ 7,176	$ 9,167

Amounts recognized in statement of operations	**Year Ended December 31, 2020**	**Year Ended December 31, 2019**
Interest on lease liabilities	$ 330	$ 325

Amounts recognized in statement of cash flows	**Year Ended December 31, 2019**	**Year Ended December 31, 2019**
Payment of lease liabilities	$ 2,650	$ 2,431

15. Commitments

	December 31, 2020	December 31, 2019
Capital expenditure commitments	$ 1,029	$ 80

16. Income taxes

Income tax expense	**2020**	2019
Current tax expense		
Current period	$ 7,827	$ 6,425
Deferred tax expense (recovery)		
Origination and reversal of temporary differences	(924)	(579)
Decrease in tax rate	1	36
	(923)	(543)
Total income tax expense	$ 6,904	$ 5,882

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Reconciliation of effective tax rate

	2020	2020	2019	2019
Net earnings		$ 14,062		$ 11,607
Income tax expense		6,904		5,882
Earnings before income taxes		$ 20,966		$ 17,489
Income tax (recovery) using the Company's domestic tax rate	39.50%	8,282	39.50%	6,908
Effect of tax rates in foreign jurisdictions	(12.03%)	(2,522)	(10.36%)	(1,811)
Decrease in tax rate	0.00%	–	0.20%	36
Non-deductible expenses/non-taxable income	0.43%	90	2.23%	390
Reduced rate for active business and manufacturing and processing	(2.69%)	(564)	(4.25%)	(744)
Losses for which no deferred tax asset was recognized	(1.40%)	(294)	3.56%	623
Dividend withholding tax	6.11%	1,281	3.72%	650
Other	3.01%	631	(0.97%)	(170)
	32.93%	$ 6,904	33.63%	$ 5,882

Unrecognized temporary differences

At December 31, 2020, pre-tax temporary differences of $80,250,000 (2019 – $96,643,000) related to investments in subsidiaries were not recognized because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future. The tax liability in the event the Company were to sell these investments would be $10,031,000 (2019– $12,080,000) based on current tax rates.

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

	2020	2019
Tax losses	$ 13,777	$ 12,458
Basis difference in subsidiary	31,361	37,356
Financial interests deductible in a future period	3,381	2,875
Expected credit losses	–	900
Inventory provisions	332	361
	$ 48,851	$ 53,950

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

Recognized deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities	
	2020	**2019**	**2020**	**2019**
Property, plant and equipment	$ 849	$ 766	$ (4,075)	$ (4,763)
Intangible assets	4	–	(641)	(767)
Scientific research and experimental development	44	9	(32)	(46)
Inventories	291	228	–	–
Long-term lease and note receivable	–	–	(3,636)	(2,974)
Loans and borrowings	2,414	3,123	–	–
Employee benefits	340	233	(160)	(153)
Unrealized losses (gains) on forward contracts and foreign-currency denominated loans payable/receivable	201	728	(71)	–
Provisions and tax reserves	1,964	1,465	(2)	(2)
Tax loss carry-forwards	2,035	1,151	–	–
Charitable donation carry-forwards	–	–	–	–
Basis difference in subsidiary	1,448	1,127	–	–
Tax assets (liabilities)	9,590	8,830	(8,617)	(8,705)
Set off of tax	(7,781)	(6,886)	7,781	6,886
Net tax assets (liabilities)	$ 1,809	$ 1,944	$ (836)	$ (1,819)

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Movement in temporary differences during the year ended December 31, 2020

	Balance December 31, 2019	Recognized in retained earnings	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2020
Property, plant and equipment	$ 3,997	$ –	$ (771)	$ –	$ 3,226
Intangible assets	767	–	(130)	–	637
Scientific research and experimental development	37	–	(49)	–	(12)
Inventories	(228)	–	(63)	–	(291)
Long-term lease and note receivable	2,974	–	662	–	3,636
Loans and borrowings	(3,123)	–	709	–	(2,414)
Employee benefits	(80)	–	(100)	–	(180)
Unrealized gains on forward contracts and foreign-denominated loans payable/receivable	(728)	–	598	–	(130)
Provisions and tax reserves	(1,463)	–	(499)	–	(1,962)
Tax loss carry-forwards	(1,151)	–	(884)	–	(2,035)
Basis difference in subsidiary	(1,127)	–	(321)	–	(1,448)
	$ (125)	$ –	$ (848)	$ –	$ (973)
Foreign exchange			$ (75)		
Income tax expense			$ (923)		

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

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

17. Share capital

(a) Authorized:

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

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

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

(b) Issued:

		December 31, 2020	December 31, 2019
8,966,624	Class A subordinate voting shares (2019 – 8,966,624)	$ 14,484	$ 14,484
2,778,300	Class B common shares (2019 – 2,778,300)	7	7
11,744,924	Total A and B shares (2019 – 11,744,924)	$ 14,491	$ 14,491

During the year ended December 31, 2020 there were no stock options exercised. During the year ended December 31, 2019, 45,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $290,000 and a transfer of $49,000 from contributed surplus.

During 2019, the company purchased and cancelled 40,800 Class A shares under a normal course issuer bid at a cost of

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$316,000 of which $65,000, $12,000, $239,000 was applied against share capital, contributed surplus and retained earnings respectively. The normal course issuer bid was completed in Quarter 3, 2019. There was no share repurchase transactions during 2020.

The following dividends were declared and paid by the Company:

	December 31, 2020	December 31, 2019
34 cents per Class A subordinate voting shares (2019 – 28 cents)	$ 3,048	$ 2,509
34 cents per Class B common shares (2019 – 28 cents)	945	778
	$ 3,993	$ 3,287

(c) Stock option plan

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

There were no options granted for the year ended December 31, 2020, or the year ended December 31, 2019.

Options outstanding and exercisable as at December 31, 2020:

	December 31, 2020		December 31, 2019	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	330,000	$ 7.99	509,000	$ 8.32
Exercised	0	–	(45,000)	6.43
Cancelled	(10,000)	6.20	(15,000)	9.17
Expired	(130,000)	10.00	(119,000)	9.74
Outstanding, end of year	190,000	$ 6.77	330,000	$ 7.99

	Options outstanding			Options exercisable	
Exercise price	Number of options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$ 7.50	65,000	0.2	7.50	65,000	7.50
6.62	55,000	1.2	6.62	55,000	6.62
6.20	70,000	2.2	6.20	70,000	6.20
	190,000	1.2	$ 6.77	190,000	$ 7.99

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Terms and conditions of the stock option plan

Options grants detailed below vest as follows:

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

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

Option Grant Date	Number of Options	Recipients
March 13, 2014	65,000	Board of Directors, Officers and Senior Management
March 12, 2015	55,000	Board of Directors and Officers
March 10, 2016	70,000	Board of Directors and Officers
Total stock options outstanding	190,000	

(d) Deferred Share Units

Under the Company's DSU Plan, participants may elect to defer compensation and receive DSUs equal to the value of the deferred compensation. The first DSUs were issued in March 2017. The number of DSUs was determined by dividing the amount of deferred compensation by the fair market value ("FMV") of DSUs, defined in the DSU Plan as the weighted average closing price of HPS shares for the five business days immediately preceding the relevant date. Upon the occurrence of the redemption event, which could include ceasing to hold any position in the Company and/or any subsidiary or upon death of the participant, the affected participant will be entitled to receive a lump sum cash payment, net of applicable withholding taxes, equal to the product of number of DSUs held by that participant and the FMV on the date of the redemption event. The DSUs do not contain any vesting conditions or forfeiture provisions, as they are issued in exchange for deferred compensation, nor are they performance based. Under the DSU Plan, outstanding DSUs as at the record date are increased by the dividend rate whenever dividends are paid to shareholders.

The movement in DSUs for the years ended December 31, 2019 and 2020 is as follows:

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

	Number of DSUs	Closing Share Price	
Balance at January 1, 2020	121,571	$	7.68
DSUs Issued	65,905		6.99
DSUs redeemed	(14,788)		6.24
DSUs forfeited	(12,154)		7.17
Balance at December 31, 2020	160,534	$	8.47

An expense of $518,000 (2019 – $367,000) was recorded in general and administrative expenses. The liability of $1,360,000 (2019 – $934,000) related to these DSUs is included in accounts payable and accrued liabilities.

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18. Earnings per share

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

		2020		2019
Basic earnings per share from continuing operations	$	1.20	$	1.13
Calculated as:				
Net Earnings attributable to the equity holders of the Company from continuing operations	$	14,062	$	13,306
Weighted average number of shares outstanding		11,744,924		11,735,495
Fully diluted earnings per share from continuing operations	$	1.20	$	1.13
Calculated as:				
Net Earnings attributable to the equity holders of the Company from continuing operations	$	14,062	$	13,306
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares		11,748,360		11,755,662
Reconciliation of weighted average number of shares outstanding:				
Weighted average number of shares outstanding used to calculate basic earnings per share		11,744,924		11,735,495
Adjustment for dilutive effect of stock option plan		3,436		20,167
Weighted average number of shares outstanding used to calculate diluted earnings per share		11,748,360		11,755,662

As at December 31, 2020, 120,000 options (2019 – 195,000) are excluded from the diluted average number of shares calculation as their effect would have been anti-dilutive.

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

	2020	2019
Basic loss per share from discontinued operations	$ –	$ (0.14)
Calculated as:		
Net loss attributable to the equity holders of the Company from discontinued operations	$ –	$ (1,699)
Weighted average number of shares outstanding	11,744,924	11,735,495
Fully diluted loss per share from discontinued operations	$ –	$ (0.14)
Calculated as:		
Net loss attributable to the equity holders of the Company from discontinued operations	$ –	$ (1,699)
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares	11,744,924	11,735,495
Reconciliation of weighted average number of shares outstanding:		
Weighted average number of shares outstanding used to calculate basic earnings per share	11,744,924	11,735,495
Adjustment for dilutive effect of stock option plan	–	–
Weighted average number of shares outstanding used to calculate diluted earnings per share	11,744,924	11,735,495

	2020	2019
Basic earnings per share	$ 1.20	$ 0.99
Calculated as:		
Net Earnings attributable to the equity holders of the Company	$ 14,062	$ 11,607
Weighted average number of shares outstanding	11,744,924	11,735,495
Fully diluted earnings per share	$ 1.20	$ 0.99
Calculated as:		
Net Earnings attributable to the equity holders of the Company	$ 14,062	$ 11,607
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares	11,748,360	11,755,662
Reconciliation of weighted average number of shares outstanding:		
Weighted average number of shares outstanding used to calculate basic earnings per share	11,744,924	11,735,495
Adjustment for dilutive effect of stock option plan	3,436	20,167
Weighted average number of shares outstanding used to calculate diluted earnings per share	11,748,360	11,755,662

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19. Pension plans

Defined contribution plan:

The Group has defined contribution pension plans that are available to virtually all of its Canadian employees with eligible employee contributions based on 2.00% – 6.75% of annual earnings. The Group's contributions of $1,655,000 (2019 – $1,586,000) matches the employee contributions. The Group's contributions related to its defined contribution pension plans are recorded as follows: $1,240,000 (2019 – $1,190,000) in cost of sales, $205,000 (2019 – $197,000) in selling and distribution, and $210,000 (2019 – $199,000) in general and administrative.

20. Provisions

	Warranties	Site restoration	Benefits	Restructuring	Total
Balance at January 1, 2019	$ 581	$ 178	$ 296	$ 6,232	$ 7,287
Provisions made during the period	807	130	19	947	1,903
Provisions used during the period	(768)	(109)	(86)	(4,197)	(5,160)
Recovery of provisions (note 24)	–	–	–	(2,035)	(2,035)
Balance at December 31, 2019	$ 620	$ 199	$ 229	$ 947	$ 1,995
Balance at January 1, 2020	$ 620	$ 199	$ 229	$ 947	$ 1,995
Provisions made during the period	1,439	257	61	–	1,757
Provisions used during the period (note 24)	(392)	(225)	(60)	(855)	(1,532)
Recovery of provisions (note 24)	–	–	–	(92)	(92)
Balance at December 31, 2020	$ 1,667	$ 231	$ 230	$ –	$ 2,128
Current portion	$ 1,667	$ 86	$ 58	$ –	$ 1,811
Non-current portion	$ –	$ 145	$ 172	$ –	$ 317

Warranties

The provision for warranties relates mainly to transformers sold during the years ended December 31, 2020 and December 31, 2019. The provision is based on estimates made from historical warranty data associated with similar products and claims experience. The Group expects to incur most of the liability over the next year.

Site restoration

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

Benefits

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

Restructuring charges

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

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21. Sales

	2020	2019
Canada	$ 109,080	$ 116,996
United States and Mexico	198,324	225,709
India	14,693	16,077
	322,097	358,782
Italy – discontinued operations	–	281
	$ 322,097	$ 359,063

As at December 31, 2020 the Company had contract liabilities of $204,000 (2019 – $268,000) included in accounts payable and accrued liabilities.

22. Government assistance

The Government of Canada implemented the Canada Emergency Wage Subsidy program (“CEWS”) that provides a subsidy of up to 75% of eligible remuneration paid by an eligible entity that experienced significant revenue declines due to the COVID-19 global pandemic. In 2020, the Company has qualified for subsidy payments. The subsidy amounts relating to the year have been recorded as a reduction in expenses as follows: cost of sales $5,557,000, selling and distribution $776,000 and general and administrative $1,950,000 for a total of $8,283,000.

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23. Discontinued operations

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

The 2020 Italy operations consist of an investment property which continues to be presented within continuing operations.

		2019
Revenue	$	281
Cost of sales		1,461
Gross loss		(1,180)
Selling and distribution		225
General and administrative		335
Impairment of goodwill, intangibles and plant and equipment		–
Restructuring charges (recovery)		(728)
Loss from operations		(1,012)
Interest income		–
Loss on disposition of assets		(687)
Loss from discontinued operations before tax		(1,699)
Income tax		–
Loss from discontinued operations, net of tax	$	(1,669)

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

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

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Cash flows from discontinued operations

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

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

24. Restructuring charges

2019 activity

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

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

The amount of the cancellation and closure costs have been included in provisions in the amount of $947,000.

2020 activity

During 2020 the cancellation and closure costs of $855,000 were paid and $92,000 of the provision was reversed into income to bring the provision balance to nil. The expected credit loss related to the VAT receivable continues to be provided for and is included in the net accounts receivable value in the amount of $339,000.

25. Related party transactions

Related parties

Arathorn Investments Inc. beneficially owns 2,778,300 (2019 – 2,778,300) Class B common shares of the Company, representing 100% of the issued and outstanding Class B common shares of the Company and 1,065,191 (2019 – 1,063,152) Class A subordinate voting shares of the Company, representing approximately 11.9% (2019 – 11.9%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. All of the issued and outstanding shares of Arathorn Investments Inc. are owned by William G. Hammond, Chief Executive Officer and Chairman of the Company. Total dividends paid during the year, directly and indirectly to William G. Hammond were $1,306,000 (2019 – $1,075,000).

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Key management personnel compensation

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

		2020		2019
Salaries and benefits	$	2,809	$	2,308
Share-based awards		518		367
	$	3,327	$	2,675

26. Personnel expenses

		2020		2019
Wages and salaries	$	57,246	$	58,972
Group portion of government pension and employment pension and employment benefits		16,636		16,314
Contributions to defined contribution plans		1,655		1,586
	$	75,537	$	76,872

27. Change in operating working capital

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

		2020		2019
Accounts receivable	$	10,926	$	5,006
Inventories		1,720		(2,290)
Prepaid expenses and other assets		(15)		(384)
Accounts payable and accrued liabilities		(11,115)		119
Provisions		(947)		(5,160)
Foreign exchange		(5,561)		(3,665)
	$	(4,992)	$	(6,374)

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28. Segment disclosures

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

Geographic Segments		**2020**		2019
Sales				
Canada	$	109,080	$	116,996
United States and Mexico		198,324		225,709
India		14,693		16,077
		322,097		358,782
Italy – discontinued operations		–		281
	$	322,097	$	359,063
Property, plant and equipment and right-of-use assets – net				
Canada	$	15,981	$	17,667
United States		7,767		6,769
Mexico		3,929		5,183
Italy		75		95
India		2,620		2,754
	$	30,372	$	32,468
Investment in properties				
Canada	$	1,044	$	1,044
Italy		2,605		2,665
	$	3,649	$	3,709
Investment in joint venture				
Mexico	$	13,300	$	13,428
Intangibles, net				
Canada	$	3,593	$	3,641
Italy		8		17
India		2,300		2,673
	$	5,901	$	6,331
Goodwill				
Canada	$	2,180	$	2,180
India		8,728		9,129
	$	10,908	$	11,309

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29. Financial instruments

Fair value

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

The Group's financial instruments measured at fair value consist of foreign exchange forward contracts with a fair value of a net liability of $1,952,000 (2019 – net liability of $1,392,000) and are included in Level 2 in the fair value hierarchy. To determine the fair value of the contracts, Management used a valuation technique in which all significant inputs were based on observable market data. There have been no transfers between levels in 2020 or 2019. The gains and losses from these contracts are grouped with foreign exchange gain on the statement of operations.

The carrying values of cash and cash equivalents, accounts receivable, bank operating lines of credit, and accounts payable and accrued liabilities and other liabilities approximate their fair value due to the relatively short period to maturity of the instruments. The Group's note receivable is valued at the present value of the future receipts and has a fair value of $nil due to collection concerns. The lease receivable is valued at the present value of the future receipts which approximates the fair value

Derivative instruments

The Group has entered into forward foreign exchange contracts in order to reduce the Company's exposure to changes in the exchange rate of the U.S. dollar, Euro, Mexican Peso and Indian Rupee as compared to the Canadian dollar. At December 31, 2020, the Company had outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2021.

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	11,800	1.5540
BUY	EUR	USD	5,700	1.2210
BUY	USD	CAD	83,500	1.2704 - 1.3099
BUY	USD	INR	8,949	73.0300 - 74.4800
BUY	USD	MXN	12,657	19.892
Buy/Sell	**Sell Currency**	**Buying Currency**	**Amount of Sell Currency**	**Traded Rate**
SELL	USD	MXN	25,000	19.9260 – 20.1420
SELL	EUR	CAD	23,600	1.5541-1.5550
SELL	EUR	USD	11,400	1.1846 – 1.2221
SELL	USD	CAD	46,500	1.2702
SELL	USD	INR	4,529	72.8500

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At December 31, 2019, the Company has outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2020.

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	9,200	1.4562
BUY	EUR	USD	8,000	1.1212
BUY	USD	CAD	104,000	1.2990 - 1.3306
BUY	USD	INR	9,198	71.4200 - 72.0900
BUY	USD	MXN	12,357	18.9440
Buy/Sell	**Buy Currency**	**Selling Currency**	**Amount of Buy Currency**	**Traded Rate**
SELL	USD	MXN	24,000	18.9898 - 19.5083
SELL	EUR	CAD	18,400	1.4574 - 1.4682
SELL	EUR	USD	16,000	1.1041 - 1.1222
SELL	USD	CAD	52,000	1.2985
SELL	USD	INR	4,634	71.2000

As at December 31, 2020 the Group has recognized a net unrealized loss of $1,952,000 representing the fair value of these forward foreign exchange contracts, comprised of an obligation recognized within accounts payable and accrued liabilities. As at December 31, 2019 the Group recognized a net unrealized loss of $1,392,000, comprised of obligation recognized within accounts payable and accrued liabilities.

Financial risk management

The Group is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk, interest rate risk and commodity price risk) credit risk and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance. There were no changes to types of risk arising from the Group's financial instruments from the previous period.

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

Currency risk

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

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The following table represents the Group's balance sheet exposure to currency risk as at December 31, 2020:

	U.S. Dollars		Mexican Pesos		Euros		Indian Rupees	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019
Cash	$ 5,928	$ 10,639	852	3,680	€ 1,526	€ 1,717	187,323	71,670
Accounts receivable	20,526	28,575	24,377	26,387	831	1,238	227,817	289,551
Long-term lease receivable	–	–	–	–	2,208	2,332	–	–
Bank operating lines of credit	(4,622)	(8,160)	–	–	(3,074)	(3,144)	–	–
Accounts payable	(13,373)	(19,507)	(9,612)	(10,376)	(88)	(359)	(111,871)	(93,427)
Lease obligation	(6,836)	(8,170)	–	–	–	–	(6,317)	(9,295)
Net exposure	$ 1,623	$ 3,377	15,617	19,691	€ 1,403	€ 1,784	296,952	258,499

A one cent ($0.01) decline in the Canadian dollar against the U.S dollar as at December 31, 2020 would have decreased net earnings by $119,000 and increased equity by $22,000. This analysis assumes that all other variables, in particular interest rates, remained constant. Inversely, a one cent ($0.01) increase in the Canadian dollar against the U.S. dollar as at December 31, 2020 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Euro as at December 31, 2020 would have decreased net earnings by $47,000 and increased equity by $21,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Euro as at December 31, 2020 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Indian Rupee as at December 31, 2020 would have increased net earnings and equity by $54,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Indian Rupee as at December 31, 2020 would have had an equal but opposite effect.

A one cent ($0.01) decline in the Canadian dollar against the Peso as at December 31, 2020 would have decreased net earnings by $2,000 and increased equity by $10,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Peso as at December 31, 2020 would have had an equal but opposite effect.

Credit risk

Credit risk arises from the possibility that the Group's customers and counter parties may experience difficulty and be unable to fulfill their contractual obligations. The Group manages this risk by applying credit procedures whereby analyses are performed to control the granting of credit to its customer and counter parties based on their credit rating. As at December 31, 2020, the Group's accounts receivable are not subject to significant concentrations of credit risk. The long-term lease receivable is subject to credit risk, which is mitigated by the security of the related plant. The Company's maximum exposure to credit risk associated with the Group's financial instruments is limited to their carrying amount.

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

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

The Group limits its exposure to credit risk from trade receivables by establishing a reasonable payment period. Many of the Group's customers have been transacting with the Group for a number of years, and none of these customers'

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balances have been written off or are credit-impaired at the reporting date.

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

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

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

During the year, the expected credit losses for trade accounts receivables decreased $420,000 (2019 – increased $516,000), for which a recovery (2019 – expense) was recognized in general and administrative expenses. The aging of accounts receivable and the related allowance is as follows:

	December 31, 2020		December 31, 2019	
	Gross	Allowance	Gross	Allowance
Not past due	$ 35,192	$ –	$ 43,287	$ –
Past due 0-30 days	10,461	–	11,251	–
Past due 31-120 days	6,405	–	6,991	–
Past due more than 120 days	3,597	2,577	5,472	2,997
	$ 55,655	$ 2,577	$ 67,001	$ 2,997

Credit risk

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

	Carrying Amount	
	December 31, 2020	December 31, 2019
Cash and cash equivalents	$ 14,795	$ 23,371
Accounts receivable	53,078	64,004
Lease receivable	3,433	3,397
	$ 71,306	$ 90,772

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

	Carrying Amount	
	December 31, 2020	December 31, 2019
Canada	$ 19,711	$ 17,435
United States	26,297	36,987
Mexico	1,561	1,818
Italy	268	827
India	5,241	6,937
	$ 53,078	$ 64,004

Interest rate risk

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

The Group manages its interest rate risk by minimizing the bank operating lines of credit balances by applying excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis as well as actively monitoring interest rates. A 1% increase or decrease in interest rates as at December 31, 2020 would increase or decrease net earnings by approximately $161,000 (2019 – $327,000) respectively.

Commodity price risk

A large component of the Group's cost of sales is comprised of copper and steel, the costs of which can vary significantly with movements in demand for these resources and other macroeconomic factors. To manage its exposure to changes in commodity prices, the Group will enter into supply contracts with certain suppliers, and from time to time will enter into forward commodity purchase contracts. As at December 31, 2020, no forward commodity purchase contracts were outstanding (2019 – none).

Liquidity risk

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

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

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

December 31, 2020	Carrying amount	1 year or less	1-2 years	2-5 years
Bank operating lines of credit	$ 16,073	$ 16,073	$ –	–
Accounts payable and accrued liabilities	44,227	44,227	–	–
Derivative liabilities	1,952	1,952	–	–
	$ 62,252	$ 62,252	$ –	$ –

December 31, 2019	Carrying amount	1 year or less	1-2 years	2-5 years
Bank operating lines of credit	$ 32,697	$ –	$ 32,697	–
Accounts payable and accrued liabilities	54,824	54,824	–	–
Derivative liabilities	1,392	1,392	–	–
	$ 88,913	$ 56,216	$ 32,697	$ –

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

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

	Liabilities		Equity		
	Bank Operating Lines of Credit	Lease Liabilities	Share Capital	Retained Earnings	Total
Balance January 1, 2020	$ 32,697	$ 11,404	$ 14,491	$ 85,339	$ 143,931
Advances of bank operating lines of credit	(16,624)	–	–	–	(16,624)
Interest payments	(917)	–	–	–	(917)
Cash dividends paid	–		–	(3,993)	(3,993)
Repayment of lease liability	–	(2,650)	–	–	(2,650)
Total changes from financing	$ (17,541)	$ (2,650)	$ –	$ (3,993)	$ (24,184)
Other changes					
Liability-related					
Interest expense	917	330	–	–	1,247
Foreign exchange	–	(107)	–	–	(107)
Non-cash additions to lease liabilities	–	343	–	–	343
Total liability-related other changes	$ 917	$ 566	$ –	$ –	$ 1,483
Equity-related					
Net income	–	–	–	14,062	14,062
Total equity-related other changes	$ –		$ –	$ 14,062	$ 14,062
Balance December 31, 2020	$ 16,073	$ 9,320	$ 14,491	$ 95,408	$ 135,292

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

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30. Capital risk management

The Group's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future business development. The Group includes cash, bank operating lines, long-term debt and equity, comprising of share capital, contributed surplus and retained earnings in the definition of capital. The Group is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the year ended December 31, 2020.

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

	December 31, 2020	December 31, 2019
Cash and cash equivalents	$ 14,795	$ 23,371
Bank operating lines of credit	(16,073)	(32,697)
Lease liabilities	(9,320)	(11,404)
Share capital	14,491	14,491
Contributed surplus	2,498	2,498
Retained earnings	95,408	85,339
	$ 101,799	$ 81,598

31. Determination of fair values

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

(a) Derivatives

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

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

(b) Non-derivative financial assets

The fair value of the lease receivable is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

(c) Share-based payment transactions

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

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(d) Investment property

The fair values of the investment properties are based on available market evidence as determined by third party valuators using comparable property sale transactions and is considered to be valued at Level 3 of the fair value hierarchy.

32. Subsequent events

Dividends

On March 5, 2021, the Company declared a dividend of eight and a half cents ($0.085) per Class A subordinate voting shares of HPS and a quarterly cash dividend of eight and a half cents ($0.085) per Class B common shares of HPS payable on March 25, 2021 to shareholders of record at the close of business on March 18, 2021. The ex-dividend date is March 17, 2021.

HPS Offices, Manufacturing Facilities and Warehouse Locations

Canada
Hammond Power Solutions Inc.

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

15 Industrial Road
Walkerton, Ontario N0G 2V0

10 Tawse Place
Guelph, Ontario N1H 6H9

Delta Transformers Inc.

795 Industriel Boul.
Granby, Quebec J2G 9A1

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

India
Hammond Power Solutions Private Limited

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

Italy
Hammond Power Solutions S.p.A.

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

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

Ave. Avante #810
Parque Industrial Guadalupe
Guadalupe, Nuevo Leon, C.P. 67190
Monterrey, Mexico

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

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

Ave. Avante #840
Parque Industrial Guadalupe
Guadalupe, Nuevo León, México
C.P. 67190

United States
Hammond Power Solutions, Inc.

1100 Lake Street
Baraboo, Wisconsin 53913

17715 Susana Road
Compton, California 90224

6550 Longley Lane, Suite 135
Reno, Nevada 89511

Annual General Meeting of Shareholders to be held:

Thursday, May 13, 2021
1:30 p.m. (Eastern Standard Time)
Via Teleconference

Audio Conference details:
Calling from Canada or the United States: 1-800-309-1256
United States, Brooklyn and International : 1-929-477-0414

Participant Code: 345658

Corporate Information

Corporate Officers and Directors

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

Chris R. Huether
Corporate Secretary and
Chief Financial Officer

Donald H. MacAdam *+
Director

Grant C. Robinson *+
Director

David J. FitzGibbon *+
Director

Dahra Granovsky *+
Director

Fred M. Jaques *+
Director

Anne Marie Turnbull *+
Director

David M. Wood *+
Director

* Corporate Governance Committee
+ Audit and Compensation Committee

Stock Exchange Listing

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

Registrar and Transfer Agent

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

Auditors

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

Legal Representation

Dentons Canada LLP
77 King Street West, Suite 400
Toronto Dominion Centre
Toronto, Ontario M5K 0A1

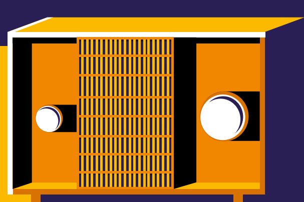
Banking Institution

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

Investor Relations

Contact: Dawn Henderson,
Manager Investor Relations
Phone: 519.822.2441 x414
Email: ir@hammondpowersolutions.com

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



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

THE HUMAN CAPACITY FOR BURDEN IS LIKE BAMBOO –
FAR MORE FLEXIBLE THAN YOU'D EVER BELIEVE
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Hammond Power
Solutions Inc.

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