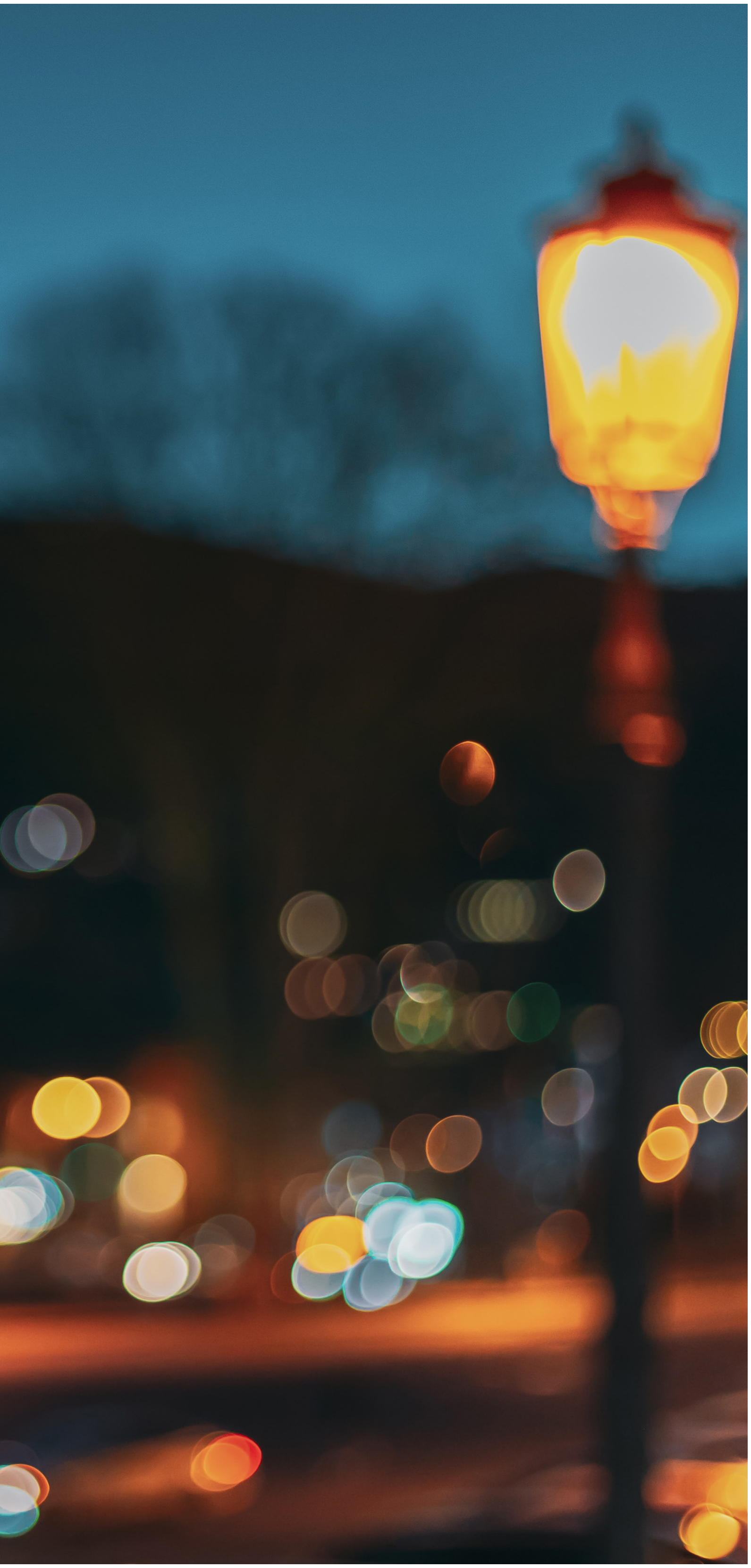
Hammond Power Solutions Inc.

Ubiquitous

ANNUAL REPORT 2022



about us

HAMMOND POWER SOLUTIONS INC.
Hammond Power Solutions Inc. (“HPS” or the “Company”) enables electrification through its broad range of dry-type transformers, power quality products and related magnetics. HPS’ standard and custom-designed products are essential and ubiquitous in electrical distribution networks through an extensive range of end-user applications. The Company has manufacturing plants in Canada, the United States (U.S.), Mexico and India and sells its products around the globe. HPS shares are listed on the Toronto Stock Exchange and trade under the symbol HPS.A.

index

22 Global Locations

1,500 Employees
Canada, United States, Mexico and India

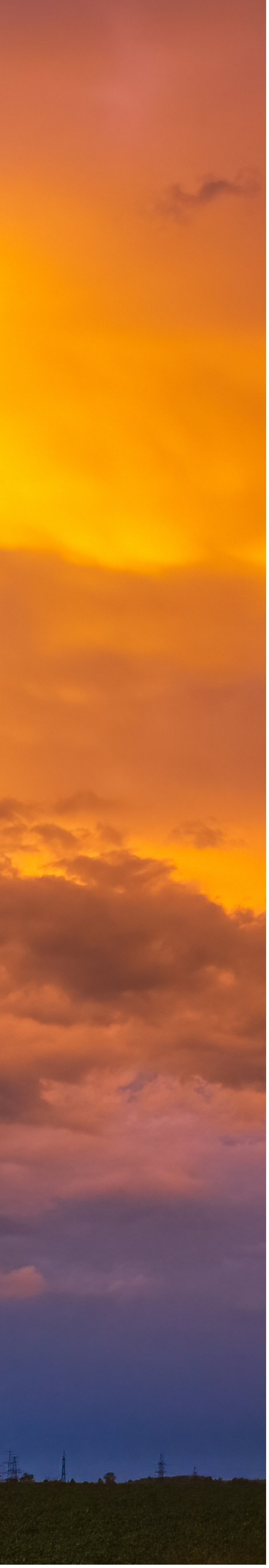
$558M Global Sales
Consistent decades of growth

~670,000 Units/year
Consistent decades of growth

Ubiquitous:
present, appearing, or found everywhere

Electricity is central to modern societies and transformers are ubiquitous.

Transformers are required wherever electrical power is needed, and one size never fits all. With an increased focus on renewable energy, electric vehicles and semiconductors, we are seeing significant changes in how the world builds infrastructure. HPS has cultivated a depth of expertise in transformer design and manufacturing, while at the same time building an enormous distribution network that allows us to access more projects and customers than ever before.



HPS' strategic vision and operational initiatives have historically resulted in industry leadership, operational strength and financial stability. In an uncertain economy, strength and stability lead to resilience and opportunity.

A company that is strong and resilient is one that is not only economically secure enough to handle both the expected and the unexpected and still maintain profitability and control growth, but also one that has a positive influence, seeks to exceed expectations and has a lasting impact. HPS at over 100 years young, has a rich and extensive history of growth, innovation and resilience, navigating through often difficult and fluctuating economic times by re-framing challenges into opportunities.

HPS has weathered the decades of time due to a ubiquitous product, a strong strategic vision, industry leadership, operational strength and financial stability. Our reputation and capabilities have led us to a place where we can participate in many end-user applications, putting us in a strong position to take advantage of the ever-increasing global investment in electrical infrastructure allowing us to withstand the test of time.

company strategy

Our purpose

We are passionate people energizing a better world.

Strategic pillars

01 Customers and Markets

Drive organic growth through competitive product offering and unparalleled customer experience and enhance strategic growth via acquisitions.

02 Operational and Financial Excellence

Achieve operational excellence through continuous improvement and efficiency plays, and grow revenue / EBITDA with opportunistic acquisitions and cost reduction initiatives.

03 People and Culture

Build the next leadership team, and be a preferred employer due to our clarity of purpose and employee value proposition.

04 Sustainability

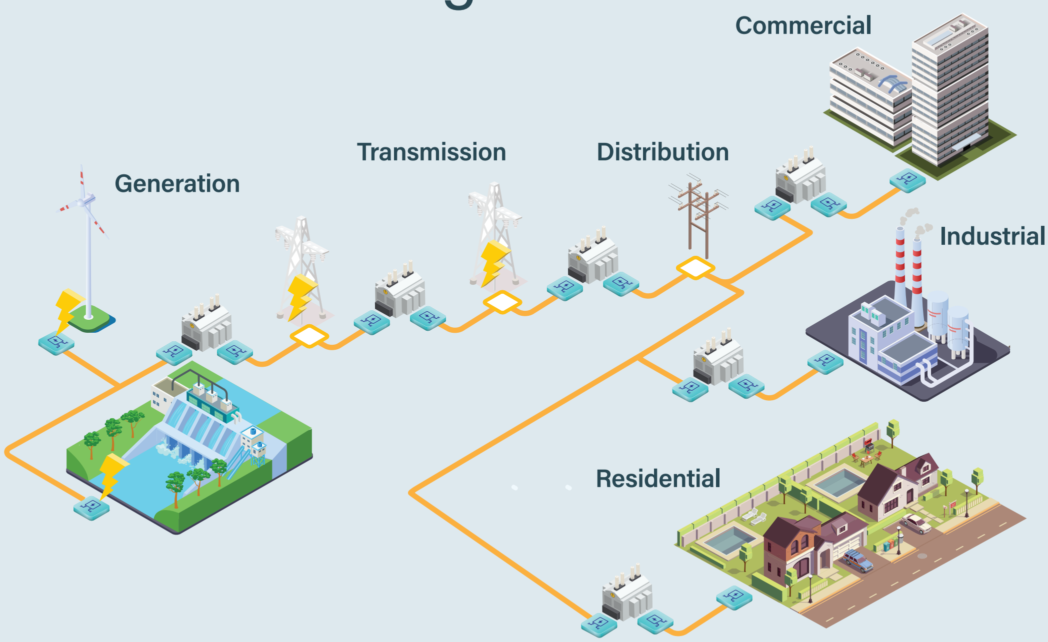
Design energy-efficient products; shrink the ecological footprint of our operations and energize the world responsibly for generations to come.

Our vision To be a leader in the electrification of our world by providing power conversion solutions to our customers while positively impacting social and environmental sustainability.

Our mission We are a talented, aligned, and collaborative team that is agile, engaged, and customer-centric. Our strong culture, technical expertise and reliability of execution allows us to meet our customers' and stakeholders' needs in an exceptional way.

Transformers are essential, multi-purpose and ubiquitous in all electrical grids.

Transformers are essential throughout the power grid. Starting at the point of generation, transformers step up power for long distance transmission. Depending on distance and voltage, several types of transformers can be used along the distribution line to step down delivery. Commercial, industrial and residential end usage require different voltage levels to supply electrical loads for use with specific equipment and consumption.



to our Shareholders

HPS Corporate Sustainability

Our passion for sustainability ensures that the world is energized today for future generations to come. We commit to designing energy-efficient products; to shrinking the ecological footprint of our operations; and to developing a workplace which fosters inclusion and innovation.

Our 5 Pillars of Sustainability

1. Economics
2. People
3. Community
4. Environment
5. Continuous Improvement

We are very proud to report another strong year of sales and profit growth to our shareholders.

We delivered these strong results in the face of significant unexpected supply chain and economic volatility. Our strong performance over the last three years is a testament to the capabilities and strengths we have built over the decades as well as the intentional strategies to diversify our sales channels within the transformer market. None of this could have happened without the tremendous effort and support of our employees in Canada, the United States ("U.S."), Mexico, and India.

We have benefited significantly from being the largest dry-type transformer manufacturer in Canada and the U.S., and our North American markets are benefiting from several tail winds. These include the burst of renewable and electric vehicle ("EV") recharging projects across the U.S. stimulated by the Bipartisan Infrastructure Deal, continuing growth of the data centre market, the re-shoring of manufacturing to the U.S. and Mexico, and the resurgence in mining of strategic metals and fertilizer to name a few.

Our plan to grow into the Mexican and Latin America ("LATAM") markets and our power quality business has begun to bear fruit in 2022. We are in the beginning stages, and we continue to see tremendous opportunity for these areas of growth as they are a natural extension of our existing business. Our strong financial performance provides a foundation to expand our manufacturing capacity and create new efficiencies to support the growth of our new and traditional business lines for years

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**

into the future. Internally, we are building a stronger organization. We have been focused on leveraging world-class technology to support our increasingly large and complex business, including our enterprise resource planning ("ERP"), human resources information system ("HRIS") and other sales support systems. We have invested in our people, ensuring that we have the right people in place, with the right skills to lead us into the future.

After 22 years as the CEO, building the company that has been in my family for more than a century, it is time for me to hand over the day-to-day decision-making process to a leader that will continue to build the Company with the same commitment to innovation and to our customers that HPS is known for. I am extremely proud of the extended Hammond family and what we have accomplished together, and I look forward to working closely with the next generation of leaders as we shape the strategy that will allow the Hammond brand to continue to grow globally.

HPS has been my home for my entire 45 year working career. This Company may bear the Hammond family name, but I am very proud that it was a place for every employee to feel a part of a close-knit group that enabled many to call it their home for their entire career as well. As the Executive Chairman, I look forward to working along side our next CEO to ensure a smooth and successful transition and collaboratively shape the long-term vision for Hammond Power Solutions.

We continue to take a conservative approach to our growth in 2023 as the global economic landscape continues to work through several years of uncertainty. In parallel, countries and jurisdictions globally are recognizing the long-term benefits of electrifying their economies and are continuing to adopt power sources with a lower carbon footprint. The fundamentals of our business are driven by demand from a broad range of end markets combined with a diversity of geography and sales channels. As countries globally continue to electrify their economies to meet their climate commitments, we believe Hammond Power Solutions will play a significant role in this global power transition.

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

building blocks of success
2022 corporate highlights

Planned Capital Program Increase

Over the next two years, HPS intends on increasing its planned capital program by approximately $40 million focused on areas targeted to increase capacity and reduce lead times for low voltage, power quality and induction heating products. Focused primarily in Mexico and the United States, these investments are expected to support HPS' supply chain resilience initiatives.

Latin America/LATAM

In 2022, HPS expanded aggressively into Mexico as a launching point into the broader Latin American market. Additional staff, training and marketing support allowed HPS to sign on new distributors to serve this growing market.

HPS Power Quality Lab September 2022

Located at HPS headquarters in Guelph, Ontario, the HPS Power Quality Lab provides HPS the ability to showcase and test power quality products to customers. Customers experience real-time testing and demonstration of line side power quality products such as transformers, line reactors, active harmonic filters and passive harmonic filters, as well as load side products. The lab will primarily be used to host consultants, distributor specialists, partners and end users who want to experience the breadth and capabilities of HPS power quality products firsthand.

2023 looking ahead

Changing the way we think about the future.

Electrification and renewables show accelerated growth with power consumption projected to triple by 2050. Electrification is the cheapest and easiest to implement in most sectors, which also makes it the fastest growing. HPS' investments in Power Quality and Induction Heating open new avenues of growth for us, allowing us to leverage our manufacturing infrastructure and distribution network to grow into the future through new technologies.

Expand production in Mexico to support growth in power quality, encapsulated, and low voltage distribution products.

Support growth of Mesta Induction Heating business.

Expand manufacturing capacity in Guelph to support larger power products, which in turn support targeted growth applications.

Continue to develop our team to cultivate the next generation of leaders, improve performance and encourage employee retention.

Formalize our sustainability initiative with standardized reporting through an established framework.

Continue to implement world-class technology to support our growing business.

growth markets

Data Centres
Growth is driven by new technologies such as the internet of things (IoT), edge computing and 5G.

Renewable Energy
Wind and photovoltaic power are experiencing exponential growth.

Continued Growth

EV Industry/Charging Stations
By 2025, the move from conventional vehicles to electric vehicles is expected to have a profound effect on the auto industry with double digit annual growth rates projected.

Oil and Gas
Continuing to secure supply while transitioning to cleaner energy in the future.

Distribution Centres
An acceleration of e-commerce supports the rise of new warehouses.

Railway Electrification
Worldwide demand continues to grow and remain at high volume.

Building it Better

Commercial Infrastructure
Urbanisation, population growth and economic expansion to support growth.

growth

Review of Operations

What does the new normal look like after the world has gone through and come out of the COVID pandemic? This decade is turning out to be the most challenging and uncertain time I've ever seen in my 45 years of being in the electrical industry. And despite all of the challenges we faced in 2022, Hammond Power Solutions performed admirably in my opinion, in fact we delivered the strongest financial performance of our 22 years of being a separate public company. I am very proud of our accomplishments, and believe that three organizational capabilities in particular contributed to our success – diversification, flexibility, and investment.

As 2021 was coming to a close, HPS and our industry in general were facing shortages of many materials and components as the world grappled with production shortfalls and supply chain disruptions. In fact, we entered 2022 with an allocated and limited supply of

core steel along with the entire global transformer industry. We were already concerned about whether we would have enough core steel from our legacy suppliers to meet the many growth opportunities we saw in North America – and then Russia invaded Ukraine. This war and the supply disruptions that occurred as a result very early in the year created even greater stress and uncertainty around how much product we could build in 2022. In addition to this uncertainty, we were hit with a rolling barrage of cost increases on all materials – core steel in particular. And on top of this, growth opportunities in existing and new markets exploded. The magnitude of these three situations was never built into our 2022 business plan, and we were quickly forced to pivot and project a new course of direction for the year and how we were going to get there.

First, our Corporate Supply Chain group did an incredible job of expanding our global supply base for core steel from European and Asian producers to not only give us a superior supply position to many of our competitors but also the ability to take on new business and grow faster than originally planned. In addition, because of our dominant industry position as well as the ability to build products when others couldn't, we were able to increase our prices multiple times through the year to cover constantly rising material costs. This pricing power was extremely important in order to preserve our profitability when other manufacturers struggled to do the same.

Our advantage of broad diversification in terms of geography, channels, markets and products along with our pricing power helped to propel the biggest year-over-year of growth we have ever experienced. This robust growth came from a wide variety of markets including electric vehicle ("EV") recharging, solar power generation, energy storage, data centre expansions, oil and gas developments, mining equipment, silica chip manufacturing as well as investments in public infrastructure like water treatment, hospitals and public transit. Several new events also contributed to this growth momentum in 2022, which we expect will fuel continuing economic activity in the years ahead. The first one is the noticeable reshoring of certain manufacturing sectors to North America in light of increasing geopolitical uncertainty and risk. These include silica chip production as well as batteries and other products related to manufacturing electric vehicles and their recharging systems. And an even bigger and unexpected boost to the U.S. economy came at the end of 2021 from the Infrastructure Investment and Jobs Act signed into law by President Biden which has injected hundreds of billions of dollars into many sectors requiring transformers, including public transportation upgrades, clean water, the electric grid, renewable energy and a nationwide network of EV recharging stations.

Our biggest growth engine in terms of sales dollars in 2022, which serves many of these growing markets, has been our U.S. distributor channel. In 2022 we expanded our distributor network by 280 new branches. And since 2020, we have added 989 new branches which have contributed over $8 million in new business just in the last three years as they come on stream. Over the last six years we have become the dominant dry transformer supplier to the U.S. distributor channel because of our broad portfolio of standard and custom products, the best training and support tools in our industry, superior stock availability from seven regional warehouses across the U.S. and our focus on building and maintaining strong personal relationships with our distributors. In addition to our distributor channel, an equally robust and important growth engine in 2022 was our Original Equipment Manufacturer ("OEM") business. A combination of traditional as well as new OEM customers in Canada and the U.S. serving sectors like data centre power systems, oil and gas equipment, pipelines, mining, water treatment, energy storage and electrical distribution systems experienced the biggest growth in over seven years with backlogs that stretch into 2024. During the year, we also expanded our sales organization based in Mexico to gradually give us the capabilities to serve dry transformer markets in Mexico, Central America and South America with the expectation of driving new sales growth of $30 million within the next 5 years.

After three years of rebuilding our Indian management team and refocusing our business coming out of the pandemic on more profitable markets, we also delivered the best financial results we have ever seen in this rapidly developing country. Total sales almost doubled as we expanded our domestic business in industrial sectors like cement manufacturing, food and beverage, pharmaceuticals, steel production, marine power, hospitals and solar power generation. We also expanded our export business in Bangladesh, Indonesia, the Philippines and the Pacific Islands.

We also enjoyed significant growth during our first full year from our most recent acquisition Mesta Electronics, Inc. ("Mesta"), with sales more than doubling because of the rapid expansion of silica chip production as well as electric battery manufacturing plants in the U.S. The active power filters that Mesta manufactures have also expanded our power quality products and capabilities that we sell both direct to OEMs as well as through our distributor channel. This relatively small but well managed company serves as an ideal acquisition model for HPS to pursue in the future in order to add tuck-in companies that will expand our penetration of new and adjacent businesses diversifying our sales and markets even more.

One reason why HPS was able to absorb so much unexpected growth in 2022 was because of our manufacturing footprint of eight plants across Canada, the U.S. and Mexico. At the end of 2021, we also converted one of our plants in India to build a limited range of low voltage distribution transformers for North America. This global footprint gave us tremendous flexibility in moving products and customer orders from one plant to another in order to meet delivery dates and to reduce our lead times. But even this hasn't been enough to serve the surging sales and future opportunities that our strategies, channels and industry-reputation are bringing us. During 2022 we increased our investment in new equipment to expand our capacities at existing plants in all four countries. And we are so confident about this positive momentum continuing over the rest of this decade, that we announced before the end of the year, a capital investment program to spend over $40 million in 2023 and 2024 to further increase our capacities. This program includes the expansions of two plants, one in the U.S. and one in Mexico, as well as building an entirely new plant in Mexico focused on small products including power quality magnetics. Our strong balance sheet gives us this flexibility and ability to invest in our organic business which is not only less risky but also tends to generate a better return on our capital.

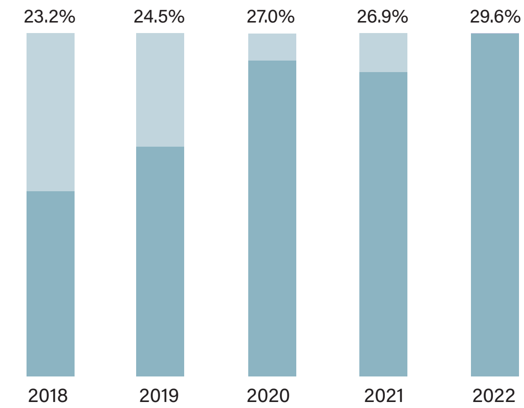
During 2022, we also continued to invest in our most valuable asset – our employees and culture. We expanded and launched new training and development programs across the organization to improve our management skills. Forty three leaders and supervisors went through this new program in 2022, and by the end of 2024 we will have put more than 150 of our current and future leaders through these skills development programs. With the help of outside consultants, we have put significant effort and time into improving communication down and across the Company in order to improve the understanding and the alignment of our employees with both our strategic as well as tactical direction, and how they can help us get there.

In addition to the above key investment projects, we implemented a new and full cloud-based upgrade to our ERP system in all twenty-two locations worldwide. Inevitably we ran into some initial teething issues given the scale of this project and launching this new system all at once everywhere, but in the end, it gives us a more secure management business system with upgraded operating and analytical tools that will help run our business more effectively and efficiently. We also started implementing the final parts of our human resource information system which will improve important areas like talent and performance management as well as simplify and enhance the employee experience.

Last but not least, after 18 months of researching the most relevant and effective ways to measure the environmental footprint of our Company, we launched a formal sustainability and Environmental, Social and Governance ("ESG") program. For years HPS has been designing and building energy-efficient products that shrink the environmental footprint of our industry, and now our ESG program is an important way to demonstrate our commitment to our employees, customers, communities and shareholders of having the most sustainable products and services possible.

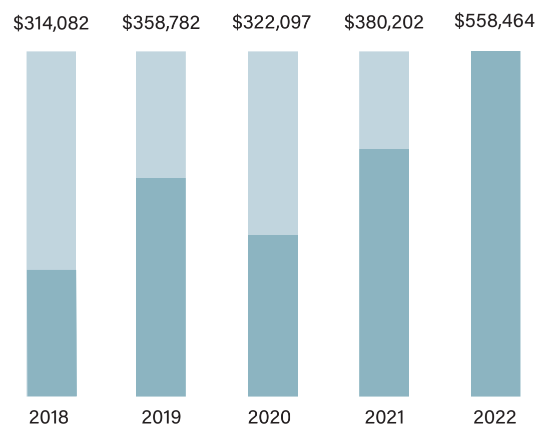
year in review

Gross Margin %



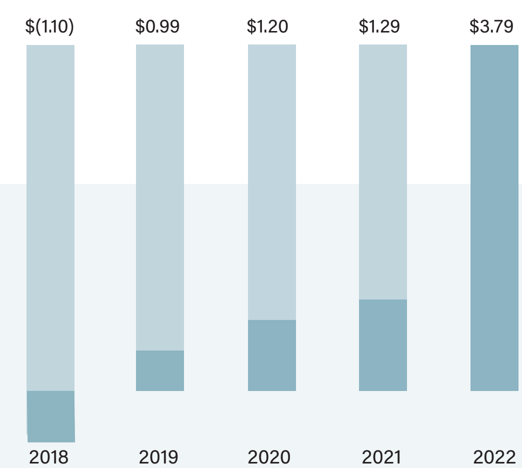
Consolidated Sales

(in thousands of dollars)



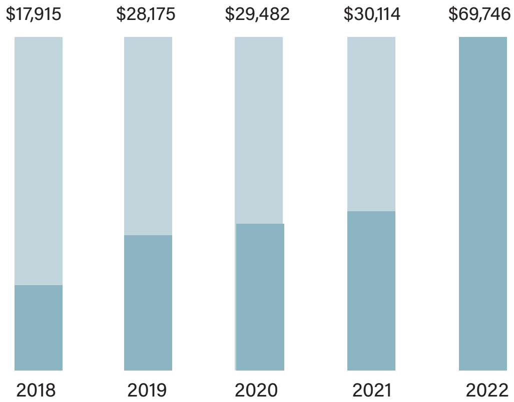
Basic Earnings (Loss) Per Share

(in dollars)



EBITDA*

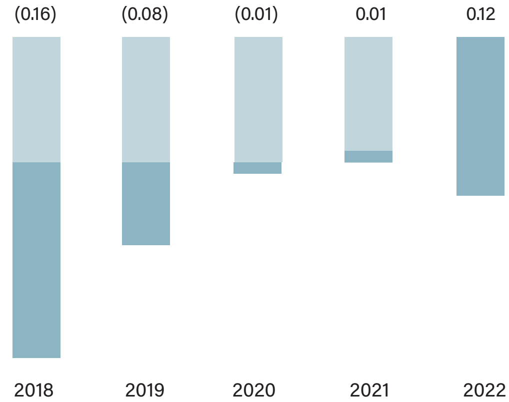
(in thousands of dollars)



* Non-GAAP financial measure, refer to page 20 of the annual report

Net Operating (Debt) Cash* to Equity

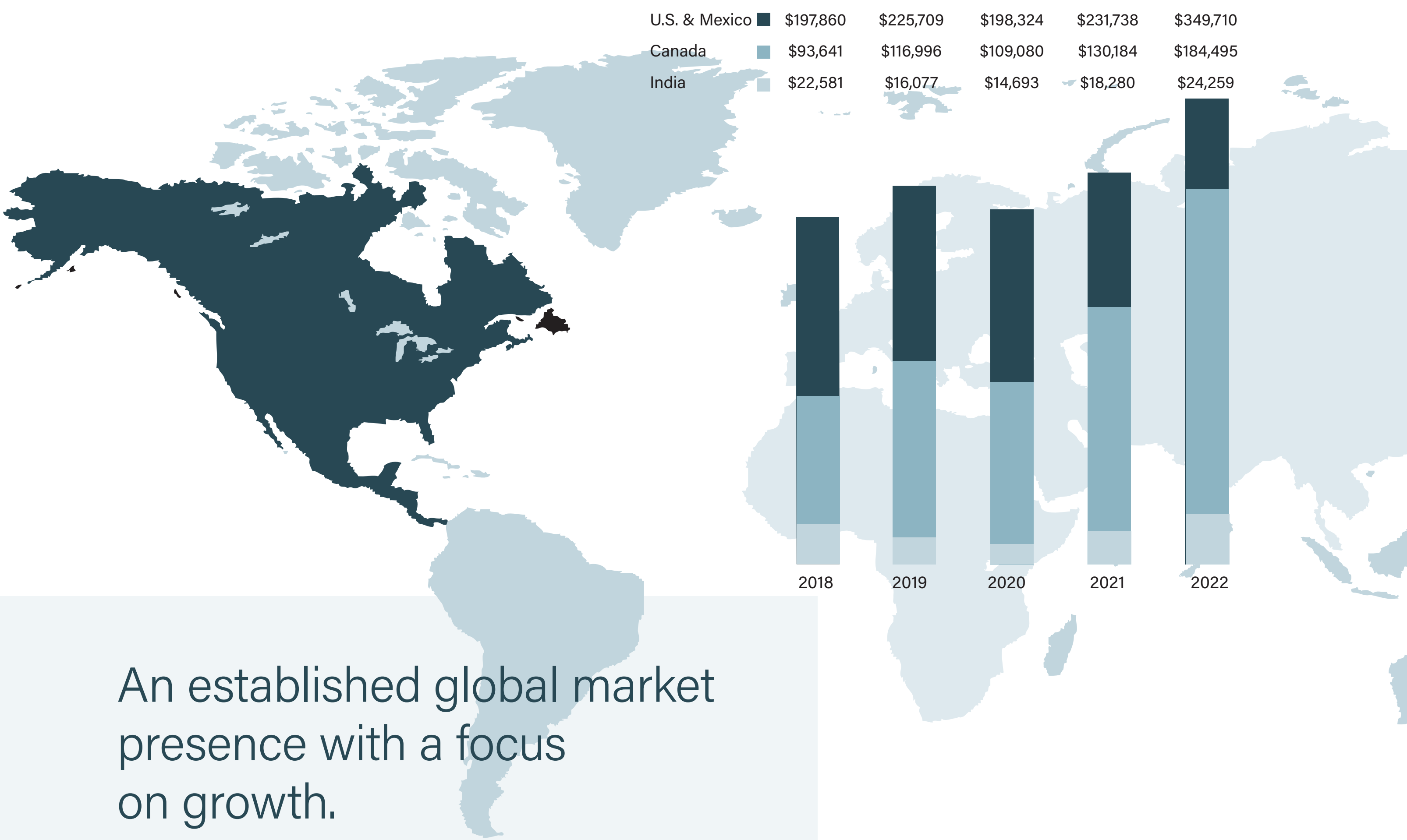
(in thousands of dollars)



* Non-GAAP financial measure, refer to page 20 of the annual report

Geographic Sales

(in thousands of dollars)



An established global market presence with a focus on growth.

Management's Discussion and Analysis

Hammond Power Solutions Inc. ("HPS" or the "Company") enables electrification through its broad range of dry-type transformers, power quality products and related magnetics. HPS' standard and custom-designed products are essential and ubiquitous in electrical distribution networks through an extensive range of end-user applications. The Company has manufacturing plants in Canada, the United States ("U.S."), Mexico and India and sells its products around the globe. HPS shares are listed on the Toronto Stock Exchange and trade under the symbol HPS.A.

Hammond Power Solutions – passionate people energizing a better world.

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, 2022 and 2021, and should be read in conjunction with the accompanying Consolidated Financial Statements of the Company as at December 31, 2022 and 2021, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This information is based on Management's knowledge as at March 23, 2023. All amounts in this report are expressed in thousands of Canadian dollars unless otherwise noted. Additional information relating to the Company may be found on SEDAR's website at www.sedar.com or on the Company's website at www.hammondpowersolutions.com.

Caution regarding forward-looking information

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

Additional GAAP and Non-GAAP measures

This document uses the terms "earnings from operations" which represents earnings before finance and other costs/(income) and income taxes. "EBITDA" is also used and is defined as earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA represents EBITDA adjusted for foreign exchange gain or loss. Net cash or net indebtedness is defined as the bank operating lines of credit net of cash and cash equivalents. Net income taxes payable or receivable is defined as current income taxes receivable less current income taxes payable. Operating earnings, EBITDA and Adjusted EBITDA are some of the measures the Company uses to evaluate the operational profitability. Net cash or net indebtedness and net income taxes payable or receivable are measures the Company uses to evaluate balance sheet strength. 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, net cash or net indebtedness, net income taxes payable/receivable, 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, 2022 and December 31, 2021 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 2022 consolidated financial statements, which comprise the consolidated statements of financial position as at December 31, 2022 and December 31, 2021, the consolidated statements of operations, comprehensive income, changes in equity and cash flows for the years ended December 31, 2022 and December 31, 2021, and Notes thereto, have been prepared under IFRS.

Overview

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 factors critical to our success.

With an established global market presence and a focus on market growth, HPS is positioned as a transformer industry leader providing standard and custom order solutions, a broad product offering, market access through multiple sales channels, outstanding quality products and exceptional service. HPS is leveraging its expertise in transformer magnetics to broaden its market presence in terms of the products it sells, the applications it serves and the geographic regions into which it sells its solutions.

Demand for HPS' products is increasing at a rapid rate, and in 2022 HPS realized its highest annual revenues in company history. HPS' customers and end-users operate in a variety of industries and the varying levels of economic activity within those industries will have an impact on HPS' overall sales. During the year, we saw activity increase in many of the markets we serve as COVID-19 pandemic restrictions diminished and economic activity surged due to strong electrification tailwinds. Many of the markets that HPS serves, such as industrial and commercial construction, utilities, infrastructure, oil and gas, mining, electric vehicle charging and renewables have all benefitted from higher-than-normal levels of investment.

HPS sells through distributors and direct to Original Equipment Manufacturer ("OEM") and private label customers. Sales through distributors tend to be made up of higher volume, standard product, whereas OEM sales tend to be customized and project-oriented sales. HPS believes that its strong focus on developing the distributor channel as well as continuing to support the OEM channel with high levels of service and quality have resulted in our growing market share in the United States ("U.S").

HPS' manufacturing capabilities are primarily located in North America, with production facilities in Canada, the U.S. and Mexico. North American production is focused on dry-type transformers, power quality products and induction heating products. These facilities form an integrated supply chain serving the Canadian, U.S. and Mexican markets. HPS also has manufacturing facilities in India, which primarily serves the Indian domestic market with oil-filled transformers. HPS saw growth in all of these markets during 2022.

One of HPS' key financial challenges in 2021 and 2022 is attributed to rising material costs and supply chain interruptions. Organic growth and supply chain disruptions in 2022 resulted in capacity constraints in some facilities. HPS responded to these challenges by focusing on building a more resilient supply chain and adding capacity where feasible in a short period of time. In response to rising material and logistic costs, we implemented several price increases during 2021 and 2022 – the full impact of which began to be realized toward the end of 2022. These increases, coupled with strong organic growth, lifted sales, bookings and backlog, particularly towards the end of 2022, and contributed to significant profit growth. Other significant drivers of sales and profitability in 2022 were, sales growth in the Mexican market which HPS entered in 2022, a strong rebound in India which made meaningful margin improvements and growth in the Mesta induction heating and harmonic filter business.

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 broad 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 its cast resin transformer technology product research and development program, which is now utilized in several HPS facilities. The 2021 acquisition of Mesta Electronics, Inc. has expanded HPS' offering into standard and custom active filter and induction heating products. Mesta shares an excellent reputation for product quality, design and reliability. Mesta not only expands HPS' U.S. presence but also broadens our power solutions product offering and manufacturing capabilities in power quality solutions. Mesta achieved significant revenue and profitability levels in 2022.

Looking forward, in an effort to deliver resilient financial performance, HPS continues to concentrate on future sales growth, additional gross margin generation and operational improvement. Globally in the U.S., Canada and Asia, HPS is well situated to grow electrical industry market share and it continues to be a leader in the markets it serves.

The Company continues to build market presence through its strong customer relationships, product capabilities, product quality, cost effectiveness, service, channel development and geographical market expansion. Booking rates and backlog continue to increase in 2022 and are strong moving into 2023. 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.

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 North American credit agreement was renegotiated in 2021 and matures in June 2026. This agreement provides the Company with the resources necessary to continue to grow and expand.

HPS remains confident in its ability to continue to generate growth – through our strategic vision merged with our operational strategies. Through HPS's strategic planning process, the Company is 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.

Sales

Sales in 2022 were $558,464 as compared to sales of $380,202 in 2021, a significant increase of $178,262 or 46.9%.

U.S. and Mexico market sales (stated in Canadian dollars) were $349,710, an increase of $117,972, or 50.9%, compared to 2021 sales of $231,738. U.S. and Mexico sales, (stated in U.S. dollars), have increased from $184,900 in 2021 to $268,733 in 2022, an increase of $83,833 or 45.3%. Sales were positively impacted by the strengthening of the U.S. dollar relative to the Canadian dollar versus 2021. The average U.S. to Canadian exchange rate for 2022 was $1.301 versus $1.253 in 2021, a U.S. dollar strengthening of 3.8%. The 2022 U.S. sales at prior year exchange rates would have been $12,858 or 3.7% lower at $336,852.

The U.S. market experienced significant increases in the OEM channel, with higher sales supporting product data centres, warehousing, industrial manufacturing, mining, electric vehicle charging, renewable energy and oil and gas production. Sales in the U.S. distributor channel also improved due to strong market activity and market penetration as additional distributors continue to be added to the network. There were also improvements in the specialty, motor control and power control markets which are partially offset by decreases in switchgear and private branding markets.

Canadian sales were $184,495, an increase of $54,311 or 41.7% as compared to sales of $130,184 in 2021. The Canadian market experienced increases in the National Association of Equipment Distributors ("NAED") and technical services which were partially offset by declines in the mining and switch gear markets.

Indian sales in 2022 were $24,259, an increase of $5,979 or 32.7% compared to sales of $18,280 in 2021. The improvement of sales year-over-year is a result of a strong post-pandemic rebound in 2022 as the first half of 2021 was impacted by government-imposed lockdowns. As of December 31, 2022 there was a significant order for $7,596 produced and shipped from India that could not be recognized given sales terms of freight on board ("FOB") destination. These sales will be recognized in Quarter 1, 2023.

Stated by geographic segment, sales in the U.S. and Mexico were 62.6 % (2021 – 61.0 %), in Canada were 33.0 % (2021 – 34.2 %) and India accounted for 4.3 %

(2021 – 4.8 %) of total sales.

Significant increases in North American sales came through established NAED and OEM channels. Distributor conversions and custom transformer capabilities continues to contribute to HPS' market share growth. The ability to continue to expand these segments is a result of new customer additions, organic customer diversity, expanded product offerings and geographically diverse manufacturing capabilities. In 2022, HPS launched its effort to sell its products into the Mexican market. Although this effort is still in the beginning stages, HPS grew its sales there to over $5.1 million U.S. dollars in 2022.

In July 2021, HPS acquired the Mesta business, which makes active harmonic filters ("AHF"), and induction heating products ("IH"). AHF were an important addition to our power quality portfolio and IH are used in the manufacture of silicon carbide. Sales for Mesta for 2022, stated in Canadian dollars, reached $14,507 (2021 - $1,042) and $11,148 (2021 - $820) stated in U.S. dollars. Mesta was a strong contributor to the overall increase in sales.

During 2022, the Company implemented two price increases, which were necessary to offset rapidly increasing costs in commodities (copper, aluminum, insulation, carbon electrical steel), freight and other components critical to manufacturing transformers. HPS began to see the full effect of those increases in 2022, which is a significant driver of the increase over the prior year. The cost increases were mainly the result of continued supply chain constraints, which continued, to some degree, throughout 2022. HPS continues to monitor material input prices and while a significant decrease in overall costs is not evident at this time, such a change could prompt lower prices in order to remain competitive.

HPS continues to be dedicated to its growth strategy. The Company's focus on product development, capital expenditures to increase capacity, vertical integration strategies, geographic diversification, innovative research and development projects and our expanded NAED network are all key components of this strategy. Expanded product offerings, the addition of new customers, geographically diverse manufacturing facilities and market influence will allow the Company to continue to grow market share globally and enable HPS as a leader in its chosen markets.

Backlog

The Company's December 31, 2022 backlog has increased by 117.1% as compared to December 31, 2021 and has increased 13.3% from Quarter 3, 2022. The combination of price increases and strong demand in the third and fourth quarters contributed to the record-high backlog. Both the direct and distributor channels contributed to higher demand towards the end of the year. The increased bookings were across a number of market and geographical segments. As the backlog grows, product lead times are extended and the timing of shipments in the backlog become more uncertain – in some cases extending to later in the year and beyond.

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. Some industry-related factors may be contributing to the higher booking rates and backlog, such as global supply chain constraints and low inventories and therefore may be temporary in nature.

Gross margin

The consolidated gross margin rate in 2022 increased to 29.6% versus 26.9% in 2021, an increase of 2.7% of sales. The improvement in the margin rate is attributed to favourable sales mix, selling price increases, higher fixed cost absorption and cost reductions.

Gross margins were affected by the sales mix, which was favourable throughout the course of 2022. Higher distribution sales, which typically have higher gross margins, but also higher selling costs contributed to higher margins. Stronger Mesta sales also resulted in margin improvement. In addition, HPS saw significant margin improvements in the Indian business.

During 2022, HPS estimates an organic volume increase of 10.0%-11.0%. This increase, along with similar organic increases in 2021, resulted in some facilities operating close or at capacity. This volume increase resulted in higher fixed overhead leverage and as a result, higher gross margins.

In the interest of protecting gross margins, HPS increased prices several times during 2021 and 2022. In the raising of prices, the Company has been proactive in anticipating cost increases, judicious in maintaining margins and conscientious of our customer relationships. For some channels, particularly those with longer backlog dates and lead times as is the case in our OEM and private label channels, raising prices is more difficult to do in a timely way due to the nature of the contracts. The Company believes that some margin deterioration occurred during 2021 as we were catching up to cost increases. In Quarter 1, 2022 sales and margins were strong with relative stability in underlying commodity costs, culminating in a strong gross margin. By contrast, Quarter 2, 2022 prices were once again lagging the cost increases brought on by global supply disruptions. Two additional price increases were implemented in 2022. These price increases partially affected Quarter 3, 2022 sales and fully impacted product sold in Quarter 4, 2022. While there remains higher than normal volatility in costs, we have seen a positive impact on margins, in the latter half of 2022. Some material input costs stabilized while others continued to increase due to underlying inflation.

The Company's ability to source materials and maintain a continuous supply to meet demand, exacerbated by global logistical disruptions, has a significant impact on sales and margins. The manufacture of transformers requires copper, aluminum and electrical steel. All of these commodities, particularly electrical steel, have seen significant price increases driven mainly by supply constraints. The second half of 2022 saw less volatility in pricing. Given the challenges and strain on the global supply markets HPS has heightened the focus on ensuring that materials required for production are received on a timely basis and when needed.

Fluctuating markets and product mix may still have a short-term impact on financial results. The global impact of the COVID-19 pandemic has impacted HPS' results over the past two years. Looking forward, the lessening impact of the economic, social and industrial aspects of the pandemic, combined with an increasing backlog, offset by indicators of a looming recession, allow for cautious optimism into 2023.

Quotation activity, improving bookings and backlog since the end of 2020 as well as an encouraging sales outlook support 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.

While some growth strategies can have a shorter-term dilutive effect on gross margin rates, the Company continues to focus on 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. While the Company has reaped the benefits of higher absorption of factory overheads due to the increased sales volume, we continue to implement a number of cost reduction and expense management initiatives to protect our margin rates. 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.

Margin rates can be sensitive to selling price pressures, volatility in commodity costs, customer mix and geographic blend. HPS' focus during the year has been on execution of its selling price realization strategies and achievement of cost reductions in an effort to protect margin rates.

Selling and distribution expenses

Total selling and distribution expenses were $62,263 for 2022 versus $46,459 in 2021, an increase of $15,804 or 34.0%. On a percentage-of-sales basis, total selling and distribution expense decreased to 11.1% of sales for 2022 from 12.2% in 2021. The higher sales value for the year resulted in additional commission expense of $6,838 and higher freight expense of $5,309 which are variable selling expenses that naturally fluctuate with sales changes. The Canadian Emergency Wage Subsidy ("CEWS") benefit in 2021 was $352 or 0.1% of sales, there was no CEWS wage support recorded in 2022. Approximately $1,366, or 0.2% of selling and distribution expenses increase relates to strategic investments in people resources, as well as increased incentive plan payments related to higher sales and profits.

General and administrative expense

General and administrative expenses in 2022 were $43,481 compared to $32,821 for 2021, an increase of $10,660 or 32.5%. On a percentage-of-sales basis these costs have decreased from 8.6% in 2021 to 7.8% in 2022. Key drivers for the current year increase are as follows:

- The CEWS benefit related to general and administrative employees in 2021 was $649 or 0.1% of sales, there was no CEWS wage support recorded in 2022;
- Approximately $3,805 of the increase in the current year is associated with strategic investments in people resources and incentive plans. There were critical roles replaced during 2021 as a large number of individuals within the organization retired;
- The Mesta acquisition contributed an additional $854 to the general and administrative expenses;
- Additional general and administrative expenses of $1,252 relate to the new infrastructure in Mexico;
- Additional investment in information technology contributed additional expenses of $1,734 related to maintenance contracts;
- The higher share price and additional awards granted in Quarter 1, 2022 has caused the DSU expense to increase $973 from prior year;
- Bad debt expense has increased $877 in 2022 over 2021, $344 of this increase is relating to a specific customer, remainder of the increase is a general provision and not representative of a pervasive problem; and
- Contingent consideration related to the Mesta acquisition increased general and administrative expenses $940,000.

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

Earnings from operations[1]

Earnings from operations improved, finishing at $59,441 in 2022, as compared to earnings of $23,151 in 2021 – an increase of $36,290 or 156.8%. The increase in earnings from operations is due to higher sales and additional gross margin dollars, offset by higher selling, distribution, general and administrative expenses.

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

	2022	2021
Net earnings for the year	$ 44,828	$ 15,176
Add:		
Income tax expense	12,341	6,074
Finance and other costs	2,272	1,901
Earnings from operations	$ 59,441	$ 23,151

Net Finance and other costs

Net finance and other costs increased $371 from $1,901 in 2021 to $2,272 in 2022. The increase from the prior year is a result of a foreign exchange gain in the current year and a loss in the prior year, as well as higher interest expense and additional expenses related to the acquisition of the Company's portion of the previous joint venture Corefficient.

Interest expense for the year-ended December 31, 2022 finished at $1,596 as compared to $1,301 in 2021, an increase of $295. Interest expense includes all bank fees.

The foreign exchange gain in 2022 of $96 related primarily to the transactional exchange gain on the Company's U.S. dollar ("USD") trade accounts receivable, compared to a foreign exchange loss of $561 in 2021. The change of the foreign exchange expense for the year is related to the volatility in the exchange rates during the year – primarily the U.S. dollar.

As at December 31, 2022, the Company had outstanding foreign exchange contracts in place for 17,350 Euros ("EUR") and $23,275 USD – both of which were implemented as a hedge against translation gains and losses on inter-company loans as well as $72,000 USD to hedge the U.S. dollar denominated accounts payable in Canadian HPS operations. The Company also had outstanding foreign exchange contracts to sell for 34,700 EUR and $61,189 USD.

Exchange rate volatility is managed by HPS' foreign exchange contract hedging program. Details of the outstanding forward foreign exchange contracts at December 31, 2022 can be found in note 27 in the Notes to Consolidated Financial Statements included in our 2022 Annual Report.

Earnings before income tax

2022 earnings before income taxes were $57,169 as compared to earnings of $21,250 in 2021 – growing by $35,919 or 169.0%. The main contributors to the higher current year earnings before income tax were higher sales and additional gross margin dollars. These gains were offset by increases in selling, distribution, general and administration expense and no government wage subsidy support in the current year.

Income taxes

Income tax expense from operations for 2022 was $12,341 as compared to $6,074 in 2021 – an increase of $6,267 or 103.2%. The consolidated effective tax rate[2] on earnings from operations for 2022 decreased to 21.6% versus 28.6% last year – a decrease of 7.0%.

The large decline in the effective tax rate for 2022 relates to the deferred tax asset generated by the improved profitability of Corefficent during 2022, after the business combination date of February 28, 2022.

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

[1] Refer to Non-GAAP financial measures on page 20 of this annual report

[2] Effective tax rate is calculated as the income tax expense divided by the earnings before income taxes.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

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 2022 Annual Report.

Net earnings

Net earnings for 2022 finished at $44,828 compared to net earnings of $15,176 in 2021, an increase of $29,652 or 195.4%. The main contributors to the higher current year net earnings were higher sales and additional gross margin dollars. These gains were offset by increases in selling, distribution, general and administration expenses, no government wage subsidy support in the current year and the lower effective tax rate in 2022.

EBITDA

EBITDA for the year-ended December 31, 2022 was $69,746 versus $30,114 in 2021 – an increase of $39,632 or 131.6%. Adjusted for foreign exchange loss/gain, adjusted EBITDA for 2022 was $69,650 versus $30,675 in 2021 – an increase of $38,975 or 127.1%.

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

		2022		2021
Net earnings	$	44,828	$	15,176
Add:				
Interest expense		1,596		1,301
Income tax expense		12,341		6,074
Depreciation and amortization		10,981		7,563
EBITDA	$	69,746	$	30,114
Add (subtract):				
Foreign exchange (gain) loss		(96)		561
Adjusted EBITDA	$	69,650	$	30,675

Summary of quarterly financial information (unaudited)

Fiscal 2022 Quarters	Q1	Q2	Q3	Q4	Total
Sales	$ 127,782	$ 137,476	$ 148,953	$ 144,253	$ 558,464
Net earnings	$ 8,569	$ 6,505	$ 11,531	$ 18,223	$ 44,828
Net earnings per share – basic	$ 0.72	$ 0.55	$ 0.97	$ 1.55	$ 3.79
Net earnings per share – diluted	$ 0.72	$ 0.55	$ 097	$ 1.53	$ 3.77
Average U.S. to Canadian exchange rate	$ 1.267	$ 1.276	$ 1.305	$ 1.358	$ 1.301

Fiscal 2021 Quarters	Q1	Q2	Q3	Q4	Total
Sales	$ 80,121	$ 88,277	$ 95,526	$ 116,278	$ 380,202
Net earnings	$ 2,298	$ 4,689	$ 3,948	$ 4,241	$ 15,176
Net earnings per share – basic	$ 0.19	$ 0.40	$ 0.34	$ 0.36	$ 1.29
Net earnings per share – diluted	$ 0.19	$ 0.40	$ 0.34	$ 0.35	$ 1.28
Average U.S. to Canadian exchange rate	$ 1.268	$ 1.231	$ 1.257	$ 1.258	$ 1.253

HPS sales have increased quarter-over-quarter for the past two years. The increase in sales is a function of increased pricing, additional market share and volume and additional sales related to a full year of Mesta, which was acquired in July 2021. There has been an upward trend over the past eight quarters due to an overall improvement in general economic activity. Sales in the current year were positively impacted by the stronger U.S. dollar exchange.

Higher sales have translated into additional profits as the additional volumes absorb more factory expenses than in the prior year.

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, 2022 financial results

	Quarter ended December 31, 2022		Quarter ended December 31, 2021	
Sales	$	144,253	$	116,278
Gross margin rate		34.4%		27.4%
Earnings from operations	$	20,369	$	6,220
Exchange (gain) loss	$	(847)	$	129
Net earnings	$	18,223	$	4,241
Earnings per share – basic	$	1.55	$	0.36
Earnings per share – diluted	$	1.53	$	0.35
Cash provided by operations	$	1,837	$	19,900

Sales for the quarter ended December 31, 2022 were $144,253, an increase of $27,975 or 24.1% from the comparative quarter last year. Sales were higher mainly due to price increases, higher exchange rates and higher volumes in the U.S. distributor and OEM channels.

Gross margin rates for the fourth quarter have increased from the same quarter last year by 7.0% from 27.4% in 2021 to 34.4% in 2022. The gross margin in the quarter was higher than what would be expected primarily due to inventory adjustments, and a favourable sales mix.

Total selling and distribution expenses amounted to $16,071 in Quarter 4, 2022 versus $14,559 in Quarter 4, 2021 – an increase of $1,512. Selling and distribution expenses as a percentage of sales have decreased to 11.1% in 2022 compared to 12.5% in 2021, a decrease of 1.4% of sales. The increases were a result of higher commission and freight variable expenses.

General and administrative expenses as a percentage of sales have decreased to 9.2% in 2022 compared to 9.5% in 2021. General and administrative expenses for Quarter 4, 2022 totaled $13,207, an increase of $2,152 when compared to Quarter 4, 2021 costs of $11,055. The Mesta acquisition expenses, new infrastructure in Mexico and additional salary and incentive costs also account for the increase in the quarter.

Quarter 4, 2022 net finance and other costs were $367 compared to $490 for the same quarter in 2021, a decrease of $123 or 25.1%. The Quarter 4, 2022 interest cost increased from $368 in Quarter 4, 2021 to $536 in Quarter 4, 2022. Foreign exchange gain in Quarter 4, 2022 was $847 compared to a foreign exchange loss of $129 in Quarter 4, 2021.

Earnings from operations for the quarter were $20,369 in 2022 and $6,220 in 2021, an increase of $14,149. Additional gross margin dollars were offset by higher general, administrative, selling and distribution expenses.

Quarter 4, 2022 income tax expense was $1,779 on earnings before income taxes of $20,002 (an effective tax rate of 8.9%) as compared to an income tax expense of $1,489 on income before income taxes of $5,730 (an effective tax rate of 26.0%) in Quarter 4, 2021. The lower Quarter 4, 2022 effective tax rate is result of a significant deferred tax assets at year-end. The deferred tax adjustment relates to the deferred tax asset generated by the improved profitability of Corefficient during 2022, after the business combination date of February 28, 2022.

Net income for Quarter 4, 2022 was $18,223 compared to net income of $4,241 in Quarter 4, 2021 – an improvement of $13,982.

Cash provided by operations for Quarter 4, 2022 was $5,352 versus $19,900 in Quarter 4, 2021 – a decrease of $14,548. The main driver for this change was cash used for working capital of $22,858 for Quarter 4, 2022 versus cash generated by working capital of $9,447 for Quarter 4, 2021, a decline of $32,305.

Overall net operating cash balance[1] was $21,972 as at December 31 2022, an improvement of $20,334 as compared to a net operating debt balance of $1,638 as at December 31, 2021, primarily reflecting improved profitability.

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 2022 was $37,013 versus $20,447 in 2021, an increase in cash generated of $16,566 or 81.0%. This increase in cash generated from operating activities was due to higher profitability, offset by an increase in non-cash working capital versus 2021. Non-cash working capital used cash of $19,539 in 2022 versus $4,777 in 2021, resulting in an increase of $14,762 from 2021. The change in non-cash working capital in 2022 was primarily a result of increases in inventory offset by increases in accounts payable and deferred revenue.

Accounts receivable finished the year at $86,701 as compared to $72,004 as at December 31, 2021, an increase of $14,697 – a result of higher sales in Quarter 4, 2022 compared to Quarter 4, 2021. HPS' days sales outstanding ratio remains stable, which can be attributed to effective credit policies and tightly managed accounts receivable administration.

Inventories finished the year at $106,353 as at December 31, 2022, versus $62,467 as at December 31, 2021, an increase of $43,886. The higher inventory levels in 2022 were attributed to increased sales volume, and the higher cost of raw materials. Mesta and Corefficient account for $11,912 of the increase in inventory for 2022.

Accounts payable and accrued liabilities, excluding derivative and share-based compensation liabilities, increased by $21,292 finishing at $92,025 as at December 31, 2022 compared to $70,733 at the end of 2021. The change in accounts payable is due to higher sales volumes, higher raw materials costs, higher accruals and the timing of purchases from and payments to suppliers.

Net income taxes payable[2] were $347 (income taxes receivable of $1,995 less income taxes payable of $2,342) as at December 31, 2022, versus net income taxes payable of $1,181 (income taxes receivable of $807 less income taxes payable of $1,988) as at December 31, 2021 – a change of $834 due to changes in the effective tax rate.

Cash used in financing activities was $22,303 in 2022, compared to cash used of $4,257 in 2021, an increase of $18,046. The change in the balance can be attributed to repayment from the operating line in 2022 compared to advances on the bank operating lines in 2021.

Cash used in investing activities in 2022 increased $1,760 from $10,914 in 2021 to $12,674 in 2022. The prior year value included the Mesta acquisition in the amount of $5,032 and the current year value included payments to National related to Corefficient. There was an increase in capital spending for property, plant and equipment of $3,595 over the prior year, totaling $8,646 in 2022 – compared to $5,051 for 2021. The Company continues to invest in the areas of manufacturing processes and capabilities as well as information technology.

Bank operating lines of credit finished the year at $6,154 as at December 31, 2022, compared to $19,267

[1] Overall net operating cash balance is the bank operating lines of credit of $6,154 net of cash and cash equivalents of $28,126

[2] Net income taxes payable consists of income taxes payable of $2,342 less income taxes receivable of $1,995 .

as at December 31, 2021 resulting in a decrease of $13,113 in the year. The Company had cash and cash equivalent balances of $28,126 as at December 31, 2022 as compared to $20,905 as at December 31, 2021.

Overall net operating cash balance was $21,972 as at December 31 2022, an improvement of $20,334 as compared to a net operating debt balance of $1,638 as at December 31, 2021, primarily reflecting improved profitability and cash generated from operations.

All bank covenants were met as at December 31, 2022, 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 $3,484. These planned capital investments are focused on areas targeted to increase capacity and reduce lead times for low voltage, power quality and induction heating products. These investments are also expected to support HPS' supply chain resilience initiatives. HPS intends to focus the capital program primarily in Mexico and the United States. In Mexico, HPS is planning to set up an approximately 80,000 square foot small products facility, while also adding equipment to existing facilities there. HPS also expects to expand its manufacturing capacity at the Mesta location in Pennsylvania, USA, as well as its facility in Guelph, Ontario.

Additional details of our change in non-cash working capital can be found in note 25 in the Notes to Consolidated Financial Statements contained in our 2022 Annual Report.

Joint venture

The Company and National Material L.P. ("National") have operated the joint venture in Monterrey, Mexico under the name Corefficient S. de R.L. de C.V. Effective February 28, 2022, the Company and National have amicably agreed to divide the operations, with HPS retaining certain equipment, employees, obligations and other financial assets and liabilities, and National withdrawing certain assets and capital in exchange for redeeming their ownership interest. The Corefficient name was also retained by National. The operation continues to produce transformer cores to supply the Group's facilities in Mexico.

Total consideration received by National in connection with this transaction was $10,809 comprised of inventory valued at $1,705, property, plant and equipment valued at $5,589 and a note payable in the amount of $3,515, repayable in six equal installments, due monthly commencing March 2022. The agreement calls for adjustments to the consideration in respect of possible realization of certain tax attributes by March 2023.

As a result of this transaction, the Company now owns 100% of the equity and voting interests of the former Corefficient (referred to here as "Corefficient") and continues to operate the entity as a wholly owned subsidiary of the Group. As the Company has acquired control of Corefficient, the transaction constitutes a business combination. The Company measured the fair value of its previously held interest in Corefficient immediately prior to obtaining control and determined it to be equivalent to its carrying value and continued the business within Hammond Power Solutions Latin America S. de R.L. de C.V.

The allocation of the fair value of the acquired business is as follows:

(in thousands of dollars)	
Cash	$ 3,393
Accounts receivable	16,513
Inventories and other assets	1,459
Property, plant and equipment	5,317
Deferred future tax asset	2,431
Assets	$ 29,113
Current liabilities	$ (15,900)
Fair value of business acquired	$ 13,213

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.

	2023	2024	2025	2026	2027 & Thereafter	Total
Accounts payable and accrued liabilities	$ 92,025	–	–	–	–	$ 92,025
Capital expenditure purchase commitments	3,484	–	–	–	–	3,484
Operating lines of credit	6,154	–	–	–	–	6,154
Derivative liability	276	–	–	–	–	276
Lease liabilities	3,198	2,979	2,090	733	103	9,103
Contingent consideration	1,509	1,337	–	–	–	2,846
Total	$ 106,646	$ 4,316	$ 2,090	$ 733	$ 103	$ 113,888

Hammond Power Solutions S.p.A – Italy

As part of the Vacuum Pressure Impregnated (VPI) asset sale agreement, the lease agreement relating to the Meledo, Italy building includes a put and call sale option related to the leased premises, exercisable within 60 days after September 30, 2023. The call option grants the purchaser an option to purchase the premises from the Company for consideration equal to 2,225 Euros ("EUR"). The plant purchase price will be reduced by 50% of the monthly rent installments received, to a maximum of 375 EUR (approximately $513). 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 $685) 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, other than contingent consideration issued in connection with the acquisition of Mesta and Corefficient. Refer to note 30 to the Consolidated Financial Statements for additional information.

Regular quarterly dividend

The Board of Directors of HPS declared quarterly cash dividend of 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, for the first quarter of 2022. The Board of Directors of HPS declared quarterly cash dividend of ten cents ($0.10) per Class A Subordinate Voting Share of HPS and ten cents ($0.10) per Class B Common Share of HPS, for the second, third and fourth quarters of 2022

The Quarter 1 dividend was paid on March 24, 2022 to shareholders of record at the close of business on March 17, 2022 – the ex-dividend date was March 16, 2022. The Quarter 2 dividend was paid on June 28, 2022 to shareholders of record at the close of business on the 21st day of June 2022 – the ex-dividend date was June 21, 2022. The dividend for Quarter 3 was paid on September 23, 2022 to shareholders of record at the close of business on September 16, 2022 – the ex-dividend date was September 15, 2022. The Quarter 4 dividend was paid on December 15, 2022 to shareholders of record at the close of business on December 8, 2022 – the ex-dividend date was December 7, 2022.

In 2022, the Company has paid a total cash dividend of thirty-eight and a half cents ($0.385) per Class A Subordinate Voting Share and thirty-eight and a half cents ($0.385) per Class B Common Share. In 2021, the Company had 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.

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, 2022, 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, 2022 such disclosure controls and procedures were operating effectively.

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 2022, which was completed in the fourth quarter.

As of December 31, 2022 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, 2022.

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

During 2022 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 was considered at a material level.

Subsequent events

Dividends

On March 7, 2023, the Company declared a dividend of twelve and a half cents ($0.125) per Class A subordinate voting shares of HPS and a quarterly cash dividend of twelve and a half cents ($0.125) per Class B common shares of HPS payable on March 23, 2023 to shareholders of record at the close of business on March 16, 2023. The ex-dividend date is March 15, 2023.

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 aware 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.

Market supply and demand impact on commodity prices

HPS relies on a global supply chain to meet its manufacturing needs. The Company sources both raw materials and components from our own factories and third-party suppliers. Industry supply shortages including those caused by logistics disruptions and global conflicts, may interrupt manufacturing production, therefore affecting our ability to ship product to customers. The Company attempts to mitigate these risks through strategic supply line agreements.

The cyclical effects and unprecedented rise of global commodity prices, including prices for copper, aluminum and electrical steel may put margins at risk. There is a risk in our ability to recoup the rapid escalating commodity costs through timely and effective selling price increases. Conversely, there is a risk that decreasing commodity costs will create competitive price pressure in our market, forcing prices down and reducing our gross margins.

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.

Risk of cyber attack

Globally there have been increased incidences of outside cyber attacks and viruses on companies' information infrastructure and technologies. A successful cyber attack could result in misappropriation of assets, cause interruptions to manufacturing and our ability to take orders, as well as impact our general productivity. This risk is reduced through a number of initiatives to mitigate exposure, including a transition to cloud-based applications, periodic risk assessments, and more robust practices around employee training and awareness and system updates.

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 initiatives may be subjective, the market may react negatively to these plans and HPS may not be able to successfully execute these plans. Even if successfully executed, the initiatives may not be effective or may not lead to the anticipated benefits within the expected time frame.

HPS' 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.

HPS does business in a host of countries around the world. Approximately 70% of our sales are to customers outside of Canada. In addition, several 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 the Company's sales and material purchases are denominated in U.S. dollars. There is a natural hedge, as sales denominated in U.S. dollars are largely 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 a number of other forms of taxation. Tax structures are subject to review by both domestic and foreign taxation authorities. 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 make it difficult or impossible to deliver our products or disrupt our global material sourcing.

Political uncertainty and potential for changes in the business environment can lead to legislative changes that could impact business.

Changing legislative mandates in the countries with which we do business may result in several 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 greater 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 competitiveness, expand capacity and improve our manufacturing flexibility.

The Company believes that being an agile organization will hold even greater importance in its ability to respond quickly to both unexpected opportunities and challenges. HPS' management believes that the key to expanding our market share 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 management's credit policy under which each new customer is analysed individually for creditworthiness before the Company's standard payment and delivery terms and conditions are offered. The Company'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 and the Company's future collection rate may differ from its historical experience.

Coronavirus (COVID-19) pandemic – business disruption/interruption

Markets, governments and health organizations around the world have been impacted by the COVID-19 pandemic. The COVID-19 pandemic has presented a wide range of issues and complications for the Company, some of which the Company is unable to know the full extent.

Looking forward there is guarded business optimism, as some uncertainty and unpredictability persists on the impacts of the COVID-19 pandemic on the business climate and governmental and health authorities' legislation. The full negative financial impact of the unprecedented pandemic will not be fully known until the economy fully recovers.

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 2022 Annual Report.

Transactions with related parties

The Company had transactions with related parties in 2022, as disclosed in note 23 in the Notes to the Consolidated Financial Statements contained in our 2022 Annual Report.

Proposed transactions

The Company had no proposed transactions as at December 31, 2022. 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, contingent consideration and the following derivative instruments.

As at December 31, 2022, the Company had outstanding foreign exchange contracts in place for 17,350 EUR and $23,275 USD – both of which were implemented as a hedge against translation gains and losses on inter-company loans as well as $72,000 USD to hedge the U.S. dollar denominated accounts payable in Canadian HPS operations. The Company also had outstanding foreign exchange contracts to sell for 34,700 EUR and $61,189 USD.

Further details regarding the Company's financial instruments and the associated risks are disclosed in note 27 in the Notes to the Consolidated Financial Statements contained in our 2022 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 judgements 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 2022 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.

Business Combinations requires acquirers to recognize the identifiable assets acquired and liabilities assumed at fair value. The determination of fair value requires Management to make estimates around the value an independent third party, under no compulsion to act, would pay for an asset acquired or liability assumed on a standalone basis. Where possible, Management engages third-party appraisers to assist in the determination of the fair value of real property acquired. The fair value of acquired intangible assets are generally determined using discounted cash flow models and involve the use of cash flow forecasts, market-based discount rates, and/or market-based royalty rates. The fair values of liabilities assumed is generally based on discounted cash flow models which involve the use of market-based discount rates. The development of cash flow forecasts involves the use of estimates, which may differ from actual cash flows realized. Assumptions are involved in the determination of discount rates and royalty rates.

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

The Company 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.

Outstanding share data

Details of the Company's outstanding share data as of December 31, 2022, are as follows:

9,056,624	Class A Shares
2,778,300	Class B Common Shares
11,834,924	Total Class A and B Shares

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

New accounting pronouncements

The Group adopted the following amendments in its financial statements for the annual period beginning on January 1, 2022. The adoption of the amendments did not have a material impact on the consolidated financial statements.

- 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); and
- Annual Improvements to IFRS Standard 2018-2020.

New accounting pronouncements to be adopted

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

The following amendments are effective for the annual period beginning on January 1, 2023:

- Insurance contracts (IFRS 17 and amendments to IFRS 17);
- Definition of accounting estimates (Amendments to IAS 8);
- Disclosure initiative – accounting policies (Amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements);
- Deferred tax related to assets and liabilities arising from a single transaction (Amendments to IAS 12 Income Taxes); and

The following amendments are effective for the annual period beginning on January 1, 2024:

- Classification of liabilities as current or non-current

(Amendments to IAS 1) and Non-current liabilities with covenants (Amendments to IAS 1); and
- Lease liability in a sale and leaseback (Amendments to IFRS 16).

Strategic direction and outlook

HPS has a rich and extensive history of growth, innovation and resilience. The Company has navigated through difficult and fluctuating economic times, increased globalization, adapted to changes in customers and markets and has experienced significant advances in technology. HPS has framed these challenges as opportunities and developed strategies to address these rapid changes.

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

- Developing our Customers and Markets by:
  - Driving organic growth through continuing to develop our NAED channel;
  - Offering competitive products, including an expanding product quality offering;
  - Providing unparalleled service to our customers; and
  - Growing through strategic acquisitions.
- Achieving Operational and Financial Excellence by:
  - Driving continuous improvement;
  - Improving efficiency by investing in equipment, people and technology; and
  - Optimizing the efficiency of our global manufacturing footprint.
- Developing our People and Culture by:
  - Building our leadership team for the future;
  - Developing our people to excel and thrive; and
  - Making HPS a preferred employer.
- Building a Sustainability Program by
  - Designing energy efficient products;
  - Shrinking our ecological footprint; and
  - Energizing the world in a responsible way for the generations to come.

The demand for our transformers particularly in North America continues to accelerate and sales volumes have returned to pre-pandemic levels. While we have seen improvements in business activity and demand, we have also experienced rapidly rising commodity costs as well as supply shortages. Based on the combination of these factors, the Company expects to see continued growth in revenues. It has been, and is, HPS' objective to maintain gross margins in the face of rising prices. We will continue to do so in the future.

We continue to add new distributors and have implemented additional infrastructure in place to support our growth initiative into Mexico. We believe that Mexico has strong potential for us as a sales market due to its proximity to our manufacturing locations and our ability to leverage existing people, product, and supply chain.

The most recent acquisition of Mesta has expanded HPS' offering into standard and custom active filter and induction heating products. Mesta shares an excellent reputation for product quality, design and reliability. Mesta not only expands HPS' U.S. presence but also broadens our power solutions product offering and manufacturing capabilities in power quality solutions. Mesta's results for 2022 contributed to both the increase in revenue as well as the increase in profits.

As of January 1, 2022, the Company went live with a new human resources information system ("HRIS") in order to move the Company to a common payroll and human resource system. This platform has enhanced our internal communications, created efficiencies, improved controls, incorporated additional career planning and allows for better data analysis.

At the end of 2022 an extensive upgrade to our enterprise resource planning ("ERP") system to a cloud based format went live. The upgrade allows for better software manufacturer support as well as speed and flexibly a cloud based system can provide. This upgrade was completed for all HPS facilities.

HPS has modern manufacturing facilities throughout the world, and this continues to be enhanced through our committed capital investment. As we grow, we are investing in equipment and machinery that will allow us to keep up with future demand and allow us to optimize our manufacturing capabilities at our various locations. We are also investing in business technology that will help us become more efficient and provide us with the data that we need to improve our business.

With a focus on growth and advancement, HPS intends to increase its planned capital program by approximately $40 million over two years. These planned capital investments are focused on areas targeted to increase capacity and reduce lead times for low voltage, power quality and induction heating products. These investments are also expected to support HPS' supply chain resilience initiatives. HPS intends to focus the capital program primarily in Mexico and the U.S.. In Mexico, HPS is planning to set up an approximately 80,000 square foot small products facility, while also adding equipment to existing facilities there. HPS also expects to expand its manufacturing capacity at the Mesta location in Pennsylvania, USA, as well as its facility in Guelph, Ontario.

The Company 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 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.

The Company has provided shareholders with strong earnings per share, solid cash generation and quarterly dividends paid with an attractive yield. To continue this trend HPS is focused on sales development, continued distributor channel expansion, product development, and bringing quality and value to all that we produce. Our strategic initiatives and focused plans will continue to allow HPS to grow and expand.

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.

Selected Annual and Quarterly Information

(tabular amounts in thousands of dollars)

Annual Information	2018	2019	2020	2021	**2022**
Sales	314,082	358,792	322,097	380,202	**558,464**
Earnings from operations	13,779	20,543	22,041	23,151	**59,441**
EBITDA	17,915	28,175	29,482	30,114	**69,746**
Net (loss) earnings	(12,917)	11,607	14,062	15,176	**44,828**
Total assets	205,527	214,953	189,394	235,099	**302,673**
Non-current liabilities	2,528	11,271	8,329	7,104	**8,101**
Total liabilities	96,793	105,186	75,478	109,097	**125,779**
Total shareholders' equity attributable to equity holders of the Company	108,734	109,767	113,916	126,002	**176,894**
Operating debt, net of cash	(17,056)	(9,326)	(1,278)	1,638	**21,972**
Cash provided by operations	6,474	17,810	19,683	20,447	**37,013**
Basic (loss) earnings per share	(1.10)	0.99	1.20	1.29	**3.79**
Diluted (loss) earnings per share	(1.10)	0.99	1.20	1.28	**3.77**
Dividends declared and paid	2,818	3,287	3,993	4,009	**4,556**
Average exchange rate (USD$=CAD$)	1.294	1.327	1.343	1.253	**1.301**
Book value per share	9.26	9.36	9.70	10.69	**15.00**

	2021				**2022**			
Quarterly Information	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Sales	80,121	88,277	95,526	116,278	127,782	137,476	148,953	144,253
Earnings from operations	3,402	7,620	5,909	6,220	12,658	10,046	16,118	20,369
EBITDA	5,349	8,694	7,378	8,693	14,458	12,225	18,970	24,093
Net earnings	2,298	4,689	3,948	4,241	8,569	6,505	11,531	18,223
Total assets	192,395	208,865	221,549	235,099	253,340	283,852	315,864	302,673
Non-current liabilities	7,546	7,018	6,486	7,104	6,170	5,793	6,640	8,101
Total liabilities	77,559	91,691	98,951	109,097	119,565	140,791	152,187	125,779
Total shareholders' equity attributable to equity holders of the Company	114,836	117,174	122,598	126,002	133,775	143,061	163,677	176,894
Operating debt, net of cash	(11,754)	(14,392)	(15,399)	1,638	(905)	9,542	21,843	5,352
Cash (used) provided by operations	(6,854)	(29)	7,430	19,900	537	14,623	16,501	1,837
Basic earnings per share	0.19	0.40	0.34	0.36	0.72	0.55	0.97	1.55
Diluted earnings per share	0.19	0.40	0.34	0.35	0.72	0.55	0.97	1.53
Dividends declared and paid	1,002	1,002	1,002	1,002	1,006	1,183	1,184	1,183
Average exchange rate (USD$=CAD$)	1.268	1.231	1.257	1.258	1.267	1.276	1.305	1.358
Book value per share	9.78	9.94	10.40	10.69	11.39	12.13	13.88	15.00

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 judgements 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 judgement 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 six are non-management directors. The Audit Committee meets periodically with management and the auditors to satisfy itself that management's responsibilities are properly discharged, to review the Consolidated Financial Statements and to recommend approval of the Consolidated Financial Statements to the Board of Directors.

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

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

Richard C. Vollering
Corporate Secretary
& Chief Financial Officer

March 23, 2023

Independent Auditor's Report

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, 2022 and end of December 31, 2021
- the consolidated statements of operations for the years then ended
- the consolidated statements of comprehensive income for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the 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, 2022 and December 31, 2021, 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 "***Auditor's Responsibilities for the Audit of the Financial Statements"*** section of our auditor's 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 judgement, were of most significance in our audit of the financial statements for the year ended December 31, 2022. 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 auditor's 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 $12,024 thousand, of which, $8,226 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 judgement 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 gross margin rate assumptions by using average actual growth rates realized in previous years to assess the 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 auditor's report thereon, included in a document entitled "Annual Report 2022".

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 filed with the relevant Canadian Securities Commissions and the Annual Report 2022 as at the date of this auditor's 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 auditor's 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.

Auditor's 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 auditor's 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 judgement and maintain professional skepticism throughout the audit.

- Responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

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
- 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 auditor's 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 auditor's 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 auditor's 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 auditor's 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 23, 2023
Waterloo, Canada

Consolidated Statements of Financial Position

(in thousands of dollars)

	As at December 31, 2022	As at December 31, 2021
Assets		
Current assets		
Cash and cash equivalents	$ 28,126	$ 20,905
Accounts receivable (note 4)	86,701	72,004
Inventories (note 5)	106,353	62,467
Income taxes receivable	1,995	807
Prepaid expenses and other assets (notes 6 and 7)	6,948	3,515
Total current assets	230,123	159,698
Non-current assets		
Long-term lease (note 7)	-	2,779
Property, plant and equipment (note 8)	41,742	30,960
Investment in properties (note 9)	3,121	3,294
Investment in joint venture (note 10)	-	13,279
Deferred tax assets (note 16)	8,013	2,370
Intangible assets (note 11)	7,650	10,503
Goodwill (note 12)	12,024	12,216
Total non-current assets	72,550	75,401
Total assets	$ 302,673	$ 235,099
Liabilities		
Current liabilities		
Bank operating lines of credit (note 13)	$ 6,154	$ 19,267
Accounts payable and accrued liabilities (notes 17 and 27)	92,301	70,733
Deferred revenue (note 21)	10,607	5,027
Income taxes payable	2,342	1,988
Provisions (note 20)	1,840	1,850
Current portion of lease and other liabilities (notes 14 and 27)	4,434	3,128
Total current liabilities	$ 117,678	$ 101,993
Non-current liabilities		
Provisions (note 20)	979	342
Deferred tax liabilities (note 16)	117	401
Long-term portion of lease and other liabilities (notes 14 and 27)	7,005	6,361
Total non-current liabilities	8,101	7,104
Total liabilities	$ 125,779	$ 109,097
Shareholders' Equity		
Share capital (note 17)	15,240	14,886
Contributed surplus	2,376	2,432
Accumulated other comprehensive income	12,431	2,109
Retained earnings	146,847	106,575
Total shareholders' equity	176,894	126,002
Commitments (note 15)		
Subsequent events (note 31)		
Total liabilities and shareholders' equity	$ 302,673	$ 235,099

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, 2022 and 2021 (in thousands of dollars except for per share amounts)

	2022	2021
Sales (note 21)	$ 558,464	$ 380,202
Cost of sales (notes 5 and 22)	393,279	277,771
Gross margin	165,185	102,431
Selling and distribution (notes 22 and 27)	62,263	46,459
General and administrative (note 22)	43,481	32,821
	$ 105,744	$ 79,280
Earnings from operations	59,441	23,151
Finance and other costs		
Interest expense	1,596	1,301
Foreign exchange (gain) loss	(96)	561
Share of income of investment in joint venture, net of tax (note 10)	(4)	(61)
Other (note 27)	776	100
Net finance and other costs	2,272	1,901
Earnings before income taxes	57,169	21,250
Income tax expense (recovery) (note 16):		
Current	15,234	7,110
Deferred	(2,893)	(1,036)
	12,341	6,074
Net earnings	$ 44,828	$ 15,176
Earnings per share (note 18)		
Basic earnings per share	$ 3.79	$ 1.29
Diluted earnings per share	$ 3.77	$ 1.28

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income

Years ended December 31, 2022 and 2021 (in thousands of dollars)

		2022		2021
Net earnings	$	44,828	$	15,176
Other comprehensive income				
Items that will be recognized within profit and loss:				
Foreign currency translation differences for foreign operations		10,322		590
Other comprehensive income, net of income tax		10,322		590
Total comprehensive income	$	55,150	$	15,766

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Years ended December 31, 2022 and 2021 (in thousands of dollars)

	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	TOTAL SHAREHOLDERS' EQUITY
Balance at January 1, 2021	$ 14,491	$ 2,498	$ 1,519	$ 95,408	$ 113,916
Total comprehensive income for the period					
Net income	–	–	–	15,176	15,176
Other comprehensive income					
Foreign currency translation differences related to joint venture (note 10)	–	–	(82)	–	(82)
Foreign currency translation differences	–	–	672	–	672
Total other comprehensive income	–	–	590	–	590
Total comprehensive income for the period	–	–	590	15,176	15,766
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 17)	–	–	–	(4,009)	(4,009)
Stock options exercised (note 17)	395	(66)	–	–	329
Total transactions with owners	395	(66)	–	(4,009)	(3,680)
Balance at December 31, 2021	$ 14,886	$ 2,432	$ 2,109	$ 106,575	$ 126,002
Balance at January 1, 2022	$ 14,886	$ 2,432	$ 2,109	$ 106,575	$ 126,002
Total comprehensive income for the period					
Net income	–	–	–	44,828	44,828
Other comprehensive income					
Foreign currency translation differences	–	–	10,322	–	10,322
Total other comprehensive income	–	–	10,322	–	10,322
Total comprehensive income for the period	–	–	10,322	44,828	55,150
Transactions with owners, recorded directly in equity					
Dividends to equity holders (note 17)	–	–	–	(4,556)	(4,556)
Stock options exercised (note 17)	354	(56)	–	–	298
Total transactions with owners	354	(56)	–	(4,556)	(4,258)
Balance at December 31, 2022	$ 15,240	$ 2,376	$ 12,431	$ 146,847	$ 176,894

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

Consolidated Statements of Cash Flows

Years ended December 31, 2022 and 2021 (in thousands of dollars)

		2022		2021
Cash flows from operating activities				
Net earnings	$	44,828	$	15,176
Adjustments for:				
Share of income of investment in joint venture		(4)		(61)
Depreciation of property, plant and equipment, right-of-use assets and investment properties		7,196		6,092
Amortization of intangible assets		3,785		1,471
Provisions		419		433
Interest expense		1,596		1,301
Income tax expense		12,341		6,074
Unrealized loss (gain) on derivatives		276		(89)
Share-based compensation expense		2,183		1,210
		72,620		31,607
Change in non-cash working capital (note 25)		(19,539)		(4,777)
Cash generated from operating activities		53,081		26,830
Income tax paid		(16,068)		(6,383)
Cash provided from operating activities		37,013		20,447
Cash flows from investing activities				
Repayment of note and lease receivable		173		185
Acquisition (notes 10 and 30)		(3,515)		(5,032)
Acquisition of property, plant and equipment		(8,646)		(5,051)
Acquisition of intangible assets		(686)		(1,016)
Cash used in investing activities		(12,674)		(10,914)
Cash flows from financing activities				
Proceeds from issue of share capital (note 17)		298		329
Cash dividends paid (note 17)		(4,556)		(4,009)
Net (repayments) advances of bank operating lines of credit		(13,113)		3,194
Interest paid		(1,277)		(1,047)
Payment of lease liabilities (note 14)		(3,004)		(2,724)
Payment of contingent consideration (note 30)		(651)		–
Cash used in financing activities		(22,303)		(4,257)
Foreign exchange on cash and cash equivalents held in a foreign currency		1,792		578
Cash acquired in business combination (notes 10 and 30)		3,393		256
Increase in cash and cash equivalents		7,221		6,110
Cash and cash equivalents at beginning of period		20,905		14,795
Cash and cash equivalents at end of period	$	28,126	$	20,905

See accompanying Notes to Consolidated Financial Statements.

1. Reporting entity

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

The consolidated financial statements of the Company comprise the Company and its subsidiaries (together referred to as the "Group" and individually as "Group entities"). The Group primarily is involved in the design and manufacture of custom electrical magnetics, cast resin, custom liquid filled distribution and power transformers and standard electrical transformers, serving the electrical and electronic industries. The Group has manufacturing plants in Canada, the United States ("U.S."), Mexico and India.

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 23, 2023.

(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. Assets acquired and liabilities assumed in connection with business combinations are recorded based on their fair values at the date of acquisition, and contingent consideration granted concurrent with a business combination is recognized initially at fair value, with subsequent measurement occurring at fair value. Changes in the fair value of contingent consideration are recorded either through the statement of operations, or through equity, depending on the characteristics of the consideration granted.

(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 statement of operations. 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.

Canadian and Subsidiary Operations	Functional Currency	
Hammond Power Solutions Inc. Delta Transformers Inc.	Canadian dollar	($)
Hammond Power Solutions, Inc. Mesta Electronics Inc. Hammond Power Solutions Latin America S. de R.L. de C.V.	U.S. dollar	($ USD)
Hammond Power Solutions S. A. de C.V. Montran S.A. de C.V.	Mexican Peso	(Pesos)
Hammond Power Solutions S.p.A. Continental Transformers s.r.l.	Euro	(EU €)
Hammond Power Solutions Private Limited	Rupee	(INR)

(d) Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRS requires Management to make judgements, 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 judgements in applying accounting policies

The following are the critical judgements, 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 judgement.

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. Management 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 Group'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 judgement 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 judgement. Management has determined that the Group operates as a single operating segment, being the design, manufacture and sale of transformers.

Identification of acquired assets and liabilities

IFRS 3, Business Combinations, requires acquirers to recognize, separately from goodwill, the identifiable assets acquired and liabilities assumed. The identification of acquired assets and liabilities involves judgement.

(ii) Key sources of estimation uncertainty

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

Recoverability of goodwill and intangible assets

The Group tests annually or more frequently if necessary, whether goodwill or other long-lived assets have suffered any impairment in accordance with the accounting policies provided in note 3(g) and 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 judgement 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.

Determination of fair value of acquired long-lived assets, intangible assets, and assumed liabilities

IFRS 3, Business Combinations, requires acquirers to recognize the identifiable assets acquired and liabilities assumed at fair value. The determination of fair value requires Management to make estimates around the value an independent third party, under no compulsion to act, would pay for an asset acquired or liability assumed on a standalone basis. Where possible, Management engages third-party appraisers to assist in the determination of the fair value of real property acquired. The fair value of acquired intangible assets are generally determined using discounted cash flow models and involve the use of cash flow forecasts, market-based discount rates, and/or market-based royalty rates. The fair values of liabilities assumed is generally based on discounted cash flow models which involve the use of market-based discount rates. The development of cash flow forecasts involve the use of estimates, which may differ from actual cash flows realized. Assumptions are involved in the determination of discount rates and royalty rates.

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.
- Montran S.A. de C.V.
- Delta Transformers Inc.
- Hammond Power Solutions Private Limited
- Continental Transformers s.r.l.
- Hammond Power Solutions S.p.A.
- Mesta Electronics, Inc.
- Hammond Power Solutions Latin America S. de R.L. de C.V.

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.

Prior to obtaining control during the year, the Company held a 55% equity interest in the Corefficient joint venture ("Corefficient"). The Company applied the equity method of accounting for its investment in Corefficient on the basis that it did not have the power to direct the key activities of the joint venture Corefficient. 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. Effective February 28, 2022, the Company and the joint venturer have agreed to divide the operations. As a result of this transaction, the Company now owns 100% of the equity and voting interests of the entity and continued the business within Hammond Power Solutions Latin America S. de R.L. de C.V. and continues to operate the entity as a wholly owned subsidiary.

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

(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 lease 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.

- Contingent consideration issued in connection with a business combination that meets the definition of a financial liability is initially recognized at fair value at the acquisition date and is subsequently re-measured at fair value at the end of each reporting period, with changes recognized 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 and other patents	10-20 years
· Software and other	4-14 years
· Branding	5-15 years

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

(f) Research and development expenses

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

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

(g) Business Combinations and Goodwill

The Group accounts for business combinations using the acquisition method when the acquired set of activities and assets meets the definition of a business and control is transferred to the Group. In determining whether a particular set of activities and assets is a business, the Group assesses whether the set of assets and activities acquired includes, at a minimum, an input and substantive process and whether the acquired set has the ability to produce outputs.

For an acquisition achieved in stages, under which the Group did not previously control an investee but subsequently obtains control, the carrying value of the Group's investment is remeasured to fair value immediately prior to the business combination, with any gain or loss reflected through the statement of operations.

The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, other contingent consideration is remeasured at fair value at each reporting date and subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

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

The impairment tests are performed at the 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, 2022.

(h) Investment properties

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 and the Italian Marnate properties, at historical cost.

(i) Joint venture

The Company applied 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 were eliminated to the extent of the Group's interest in the joint venture. Unrealized losses were 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.

(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 maintains 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. The number of DSUs issued to each holder are increased as dividends on common shares are paid to compensate the holders for dividends paid on a quarterly basis, while the DSUs are outstanding.

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. The DSU liability is included within accrued liabilities.

(m) Provisions

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

- The business or part of a business concerned;
- The principal locations affected;
- The location, function and approximate number of employees affected;
- 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. As a result, 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.

(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.

(u) New accounting pronouncements adopted during the period

The Group adopted the following amendments in its financial statements for the annual period beginning on January 1, 2022. The adoption of the amendments did not have a material impact on the consolidated financial statements.

- 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.

(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 following amendments are effective for the annual period beginning on January 1, 2023:

- Insurance contracts (IFRS 17 and amendments to IFRS 17);
- Definition of accounting estimates (Amendments to IAS 8);
- Disclosure initiative – accounting policies (Amendments to IAS 1 and IFRS Practice Statement 2 Making Materiality Judgements);
- Deferred tax related to assets and liabilities arising from a single transaction (Amendments to IAS 12 Income Taxes); and

The following amendments are effective for the annual period beginning on January 1, 2024:

- Classification of liabilities as current or non-current (Amendments to IAS 1) and Non-current liabilities with convenants (Amendments to IAS 1); and
- Lease liability in a sale and leaseback (Amendments to IFRS 16).

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

4. Accounts receivable

	December 31, 2022	December 31, 2021
Trade accounts receivable	$ 75,147	$ 67,359
Value added tax receivable	6,602	1,066
Other receivables	4,952	3,579
	$ 86,701	$ 72,004

Trade accounts receivable is presented net of expected credit losses of $2,806,000 (December 31, 2021 – $2,359,000).

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

	December 31, 2022	December 31, 2021
Opening balance	$ 2,359	$ 2,577
Additional allowances	837	214
Writeoffs	(37)	(6)
Adjustments	(353)	(426)
	$ 2,806	$ 2,359

5. Inventories

	December 31, 2022	December 31, 2021
Raw materials	$ 51,773	$ 30,731
Work in progress	3,154	4,206
Finished goods	51,426	27,530
	$ 106,353	$ 62,467

Raw materials and changes in finished goods, and work in progress recognized as cost of sales during the year amounted to $391,317,000 (2021 – $276,850,000). In addition, during the year, reversal of write-downs in the amount of $78,000 were recognized (2021 – write-downs of $23,000). Inventories carried at net realisable value as at December 31, 2022 were $485,000 (December 31, 2021 – $1,054,000).

6. Prepaid and other assets

	December 31, 2022	December 31, 2021
Prepaid expenses	$ 4,109	$ 3,121
Fair value of derivative	–	180
Current portion of long-term lease and note receivable (note 7)	2,839	214
	$ 6,948	$ 3,515

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

7. Long-term lease

Concurrent with the disposal of a product line in 2017, the Group entered into a lease agreement for one of its manufacturing facilities in Italy, under which the purchaser has the use of the plant, which includes both the land and the building, to October 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.

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 $3,047,000). 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 Euros (approximately $513,000). If the purchaser fails to complete the acquisition of the leased premises upon the exercise of the put option by the Company and pay the required consideration, the purchaser will pay 500,000 Euros (approximately $685,000) in liquidated damages. Management has determined that ownership of the leased premises is reasonably certain to be transferred by virtue of the put and call options and accordingly has accounted for the lease as a finance lease. The put and call options expire November 23, 2023.

As at December 31, 2022 consideration receivable consists of:

	December 31, 2022	December 31, 2021
Lease receivable of 1,957 EUR (2021 – 2,083 EUR), with monthly lease payments of 13 EUR, bearing interest of 1.15% per annum.		
Gross cash entitlement:	$ 2,867	$ 3,057
Less: unearned finance income	(28)	(64)
Net lease receivable	2,839	2,993
Less: current portion included within prepaid and other assets	2,839	214
	$ –	$ 2,779

The aggregate amount of principal payments are expected to be received in the next year.

8. Property, plant and equipment

Property, plant and equipment comprise 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, 2022	December 31, 2021
Property, plant and equipment owned	$ 34,789	$ 25,152
Right-of-use asset	6,953	5,808
	$ 41,742	$ 30,960

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

	Land	Buildings	Leaseholds & Improvements	Machinery & Equipment	Office Equipment	Construction in Progress & Deposits	**Total**
Cost							
Balance at January 1, 2021	$ 4,210	$ 17,979	$ 1,800	$ 54,066	$ 11,458	$ 2,618	$ 92,131
Acquisition (note 30)	-	-	-	8	-	-	8
Additions	-	564	106	2,067	486	1,828	5,051
Disposal	-	-	-	(671)	-	-	(671)
Effect of movements in exchange rates	(12)	(25)	(41)	(263)	(45)	(93)	(479)
Balance at December 31, 2021	$ 4,198	$ 18,518	$ 1,865	$ 55,207	$ 11,899	$ 4,353	$ 96,040
Balance at January 1, 2022	$ 4,198	$ 18,518	$ 1,865	$ 55,207	$ 11,899	$ 4,353	$ 96,040
Acquisition (note 10)	-	-	-	4,713	131	-	4,844
Additions (transfers)	-	1,180	335	7,405	1,237	(1,511)	8,646
Disposal	-	-	-	(54)	(16)	-	(70)
Effect of movements in exchange rates	(16)	(47)	222	2,280	231	194	2,864
Balance at December 31, 2022	$ 4,182	$ 19,651	$ 2,422	$ 69,551	$ 13,482	$ 3,036	$ 112,324
Accumulated Depreciation							
Balance at January 1, 2021	$ –	$ 12,110	$ 1,159	$ 44,848	$ 10,366	$ –	$ 68,483
Depreciation for the year	–	816	121	2,183	436	–	3,556
Disposal	–	–	–	(667)	–	–	(667)
Effect of movements in exchange rates	–	(10)	(34)	(401)	(39)	–	(484)
Balance at December 31, 2021	$ –	$ 12,916	$ 1,246	$ 45,963	$ 10,763	$ –	$ 70,888
Balance at January 1, 2022	$ –	$ 12,916	$ 1,246	$ 45,963	$ 10,763	$ –	$ 70,888
Depreciation for the year	–	826	128	2,908	703	–	4,565
Disposal	–	-	-	(52)	(15)	–	(67)
Effect of movements in exchange rates	–	(17)	190	1,795	181	–	2,149
Balance at December 31, 2022	$ –	$ 13,725	$ 1,564	$ 50,614	$ 11,632	$ –	$ 77,535
Carrying amounts							
At December 31, 2021	$ 4,198	$ 5,602	$ 619	$ 9,244	$ 1,136	$ 4,353	$ 25,152
At December 31, 2022	$ 4,182	$ 5,926	$ 858	$ 18,937	$ 1,850	$ 3,036	$ 34,789

Depreciation is recorded in the statement of earnings as follows: cost of sales $4,098,000 (2021 – $3,198,000), selling and distribution $nil (2021 – $nil) and general and administrative $467,000 (2021 – $358,000).

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

Right of use 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, 2021	$	6,187	$	529	$	8	$	6,724
Additions		853		299		44		1,196
Depreciation		(1,668)		(290)		(16)		(1,974)
Effect of movements in exchange rates		(135)		(3)		–		(138)
Balance at December 31, 2021	$	5,237	$	535	$	36	$	5,808
Balance at January 1, 2022	$	5,237	$	535	$	36	$	5,808
Additions		3,527		145		–		3,672
Disposal		(466)		(47)		–		(513)
Depreciation		(2,159)		(273)		(15)		(2,447)
Effect of movements in exchange rates		390		43		–		433
Balance at December 31, 2022	$	6,529	$	403	$	21	$	6,953

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 March 31, 2023 and carries annual lease payments of $581,000. The Group is in negotiations with the lessor to extend this lease. 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.

9. Investment in properties

		December 31, 2022		December 31, 2021
Glen Ewing Property	$	1,044	$	1,044
Marnate Property (net of accumulated depreciation of $1,624 (2021 - $1,415))		2,077		2,250
	$	3,121	$	3,294

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 2022 or 2021. The property is carried at cost. The estimated fair value of the property as at December 31, 2022 is $1,150,000 (2021 – $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 $148,000 (2021 – $139,000).

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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 in 2019, the purchaser has leased the Marnate Property for a period of five years at an annual rental amount of 90,000 EUR (approximately $131,000). The operating expenses for this property were 225, 000 EUR (approximately $326,000) in 2022 and 169,000 EUR (approximately $251,000) in 2021. Depreciation on the facility was recorded in the statement of earnings as general and administrative expenses in the amount of $184,000 (2021 - $163,000). The estimated fair value of the property as at December 31, 2022 is 1,566,000 Euros (approximately $2,272,000). The fair value was determined based on independent available market evidence, based on comparable property sales, by an independent valuator.

10. Corefficient

The Company and National Material L.P. ("National") have operated the joint venture in Monterrey, Mexico under the name Corefficient S. de R.L. de C.V. ("Corefficient "). Effective February 28, 2022, the Company and National have agreed to divide the operations, with HPS retaining certain equipment, employees, obligations, and other financial assets and liabilities, and National withdrawing certain assets and capital in exchange for redeeming their ownership interest. The Corefficient name was also retained by National. The operation continues to produce transformer cores to supply the Group's facilities in Mexico.

Total consideration received by National in connection with this transaction was $10,809,000 comprised of inventory valued at $1,705,000, property, plant and equipment valued at $5,589,000 and a note payable in the amount of $3,515,000, repayable in six equal installments, due monthly commencing March 2022.

As a result of this transaction, the Company now owns 100% of the equity and voting interests of the former Corefficient (referred to here as "Corefficient") and continued the business within Hammond Power Solutions Latin America S. de R.L. de C.V. and continues to operate the entity as a wholly owned subsidiary of the Group. As the Company has acquired control of the former joint venture, the transaction constitutes a business combination. The Company has measured the fair value of its previously held interest in Corefficient immediately prior to obtaining control and determined it to be equivalent to its carrying value.

The allocation of the fair value of the acquired business is as follows:

Cash	$	3,393
Accounts receivable and other assets		16,513
Inventories		1,459
Property, plant and equipment		5,317
Deferred future tax asset		2,431
Assets	$	29,113
Current liabilities	$	15,900
Fair value of acquired business	$	13,213

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

The accounts receivable balance of $13,928,000, included in Accounts receiveable and other assets above, is presented net of expected credit losses of $293,000. The contractual cash flows not expected to be collected is $nil.

Included in the Group's consolidated results to February 28, 2022, the date of acquisition, the Group's share of income of investment in joint venture of $4,000 (2021 - $61,000).

The agreement includes a contingent consideration element relating to unrecognized tax loss carryforwards generated by Corefficient, underwhich if the Company is able to utilize the losses following the business combination, the Company must pay National 45% of the tax savings realized, to a maximum of $837,000. As at the acquisition date, the fair value of the consideration was determined to be $nil.

The acquisition costs incurred related to this transaction during the year were $177,000 which were included in general and administrative expense.

Included in the Group's consolidated results for the twelve months ended December 31, 2022, is revenue of $5,191,000 and net earnings of $2,828,000 recognized by Corefficient from the date of acquisition to December 31, 2022. If the Company had acquired Corefficient effective January 1, 2022, the revenue would have been approximately $5,191,000 and there would have been net income of $2,834,000. The revenue for the consolidated group would have been approximately $558,464,000 and net income of the consolidated group would have been $44,834,000.

11. Intangible assets

Intangible assets		Technology and Patents		Customer lists, relationships and branding		Externally acquired software		**Total**
Cost								
Balance at January 1, 2021	$	6,119	$	8,659	$	7,438	$	22,216
Acquisition (note 30)		1,710		3,374		–		5,084
Additions		–		–		1,016		1,016
Effect of movements in exchange rates		(53)		(27)		(1)		(81)
Balance at December 31, 2021	$	7,776	$	12,006	$	8,453	$	28,235
Balance at January 1, 2022	$	7,776	$	12,006	$	8,453	$	28,235
Additions		–		–		686		686
Effect of movements in exchange rates		33		(311)		(45)		(323)
Balance at December 31, 2022	$	7,809	$	1,695	$	9,094	$	28,598

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

Accumulated Amortization								
Balance at January 1, 2021	$	4,630	$	7,181	$	4,504	$	16,315
Amortization for the year		216		833		422		1,471
Effect of movements in exchange rates		(27)		(26)		(1)		(54)
Balance at December 31, 2021	$	4,819	$	7,988	$	4,925	$	17,732
Balance at January 1, 2022	$	4,819	$	7,988	$	4,925	$	17,732
Amortization for the year		304		872		2,610		3,786
Effect of movements in exchange rates		(33)		(493)		(44)		(570)
Balance at December 31, 2022	$	5,090	$	8,367	$	7,491	$	20,948
Balance at								
At December 31, 2021	$	2,957	$	4,018	$	3,528	$	10,503
At December 31, 2022	$	2,719	$	3,328	$	1,603	$	7,650

Amortization of $2,704,000 (2021 – $617,000) has been recognized in cost of sales, $120,000 (2021 – $123,000) has been recognized in selling and distribution and $961,000 (2021 – $731,000) has been recognized in general and administrative.

None of the intangible assets has been internally developed.

Research and development expenses of $425,000 (2021 –$945,000) have been recognized in cost of sales in the consolidated statements of earnings. No research and development costs have been capitalized (2021 – $nil).

12. Goodwill and impairment testing for cash-generating units

Goodwill		**December 31, 2022**		December 31, 2021
Opening balance	$	12,216	$	10,908
Addition (note 30)		–		1,422
Effect of movements of exchange rates		(192)		(114)
Ending balance	$	12,024	$	12,216

The Company conducts its annual impairment assessment of CGUs which contain goodwill, as well as any corresponding acquired long-lived assets including 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 2022 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 three subsidiaries identified as CGUs that contain goodwill. The CGUs and their respective goodwill balances are as follows: Delta Transformers Inc. ("Delta") $2,180,000 (2021 – $2,180,000), Hammond Power Solutions Private Limited ("India") $8,226,000 (2021 – $8,527,000) and Mesta Electronics Inc. ("Mesta") $1,618,000 (2021 – $1,509,000).

For its 2022 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 the Company's 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.

India

Based on the Company's projections, a five year cash flow forecast was completed and discounted to present-value using discount rate of 18.8% (2021 - 20.0%). Through the five year cash flow projections, the Company's model also incorporated year 1 sales growth rates of 44.3% (2021 – 82.3%), which reflects additional growth in manufacturing of a product line that was new for 2022 in India. The annual sales growth rates for year 2 to year 5 are in the range of -9.1% – 19.0% (2021 – year 2 to year 5 – 10.5% – 36.2%) based on the CGUs operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using terminal growth rate of 8% (2021– 8%).

Delta

Based on the Company's projections, a five year cash flow forecast was completed and discounted to present-value using discount rate of 16.6% (2021 –12.3%). Through the five year cash flow projections, the Company's model also incorporated year 1 sales growth rates of 16.9% (2021 – 19.9%). The annual sales growth rates for year 2 to year 5 are 2.4% - 3.9% (2021 – year 2 to year 5 – 3.0%) based on the CGUs operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using terminal growth rate of 3% (2021 – 2%).

Mesta

Based on the Company's projections, a five year cash flow forecast was completed and discounted to present-value using discount rate of 27.4 % (2021 – 26.8 %). Through the five year cash flow projections, the Company's model also incorporated annualized year 1 sales growth rate of 83.0 % (2021 - 304 %). The annual sales growth rates for year 2 to year 5 are 3% (2021 – 5 % – 15.4 %) based on the CGUs operating history and strategic sales growth initiatives. Cash flows beyond the five year period have been extrapolated using terminal growth rate of 3% (2021 – 3.0 %). 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 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, 2022, a discount rate increase of 7.6% or an 8.7% lower terminal growth rate than the assumptions utilized would cause the estimated recoverable amount to be equal to the carrying amount for this CGU (December 31, 2021 – a discount rate increase of 4.8% or an 8.2% lower terminal growth rate).

For the Delta and Mesta CGUs, 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 annual impairment assessment it was determined that the recoverable amount of the CGUs exceeded their respective carrying values and no impairment existed as at December 31, 2022.

13. Bank operating lines of credit

The Group's North American current banking agreement, which expires in June 2026, consists of a $50,000,000 U.S. revolving credit facility. The revolving credit facility can be drawn in U.S. Prime borrowings, Canadian Prime borrowings, Canadian Dollar Offered Rate ("CDOR") borrowings or the London Inter-Bank Offered rate ("LIBOR") benchmark replacement rate borrowings. The facilities are unsecured.

Interest on the revolving credit lines is dependent on certain financial ratios and ranges from Canadian bank prime rate plus 0.0% to Canadian bank prime rate plus 0.4% for the Canadian dollar denominated revolving credit lines or, if designated, the bank's CDOR rate plus 1.40% to 1.90% and the Canadian overdraft loans at Canadian bank prime rate; and from U.S. base rate minus 1.00% to U.S. base rate minus 0.50% for the U.S. dollar denominated revolving credit lines or, USD overdraft loan at USD prime minus 1.00%.

The Group also has a 4,070,000 EUR unsecured Euro facility that matures June 2026 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 EUR letter of credit line. The revolver facility bears interest at 2.25% plus the relevant Market Index (2021 – plus margin of 2.25%, Euribor on December 31, 2021 – 1.75%, Euribor on December 31, 2021 – 0.499%).

Hammond Power Solutions Private Limited maintains an additional demand credit facility for an unsecured working capital loan up to 515,000,000 Indian Rupee (INR") (2021 – 515,000,000 INR) consisting of the sub-facilities of a 40,000,000 INR (2021 – 90,000,000 INR) short-term working capital demand loan, a 475,000,000 INR (2021 – 425,000,000 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, 2022, there was $nil Canadian dollar equivalent of Rupees drawn against the working capital demand loan (2021 – $nil). As at December 31, 2022 there was 265,106,000 INR, Canadian equivalent $4,347,000 (2021 – 263,604,000 INR, Canadian equivalent $4,481,000) drawings against the bank guarantees.

Based on exchange rates in effect at December 31, 2022, the combined Canadian dollar equivalent available across all facilities, prior to any utilization of the facilities was $82,122,000 (2021 – $77,788,000).

As at December 31, 2022, the Canadian dollar equivalent outstanding under the U.S. dollar revolving credit facility was $1,531,000, consisting of $1,531,000 Canadian dollars drawn and the Canadian equivalent of $nil U.S. dollars drawn (2021 – $14,777,000 – consisting of $12,598,000 Canadian dollars drawn and the Canadian equivalent of $2,179,000 U.S. dollars drawn). As well, $4,623,000 (2021 – $4,490,000) Canadian dollar equivalent of Euros was outstanding under the Euro facility, and $nil (2021 – $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.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

14. Lease and other long-term liabilities

	December 31, 2022	December 31, 2021
Lease liabilities	$ 8,593	$ 7,980
Contingent consideration (note 27)	2,846	1,509
	$ 11,439	$ 9,489
Current	4,434	3,128
Non-Current	7,005	6,361

Right of use liability maturity analysis – contractual undiscounted cash flows	**December 31, 2022**	December 31, 2021
Less than one year	$ 3,198	$ 2,762
One to five years	5,905	5,457
More than five years	-	94
Total undiscounted lease liabilities	$ 9,103	$ 8,313
Less: effect of discounting and foreign exchange	$ (510)	$ (333)
Lease liabilities included in the statement of financial position	$ 8,593	$ 7,980
Current	$ 2,925	$ 2,512
Non-current	$ 5,668	$ 5,468

Amounts recognized in statement of operations	**Year Ended December 31, 2022**	Year Ended December 31, 2021
Interest on lease liabilities	$ 232	$ 254

Amounts recognized in statement of cash flows	**Year Ended December 31, 2022**	Year Ended December 31, 2021
Payment of lease liabilities	$ 3,004	$ 2,724

15. Commitments

	December 31, 2022	December 31, 2021
Capital expenditure commitments	$ 3,484	$ 483

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

16. Income taxes

Income tax expense		**2022**		2021
Current tax expense				
Current period	$	15,234	$	7,110
Deferred tax recovery				
Origination and reversal of temporary differences		(2,894)		(1,071)
Decrease in tax rate		1		35
		(2,893)		(1,036)
Total income tax expense	$	12,341	$	6,074

Reconciliation of effective tax rate	**2022**		**2022**	2021		2021
Net earnings		$	44,828		$	15,176
Income tax expense			12,341			6,074
Earnings before income taxes			57,169			21,250
Income tax expense using the Company's domestic tax rate	39.50%		22,582	39.50%		8,394
Effect of tax rates in foreign jurisdictions	(12.82%)		(7,328)	(12.49%)		(2,654)
Decrease in tax rate	0.00%		1	0.16%		34
Non-deductible expenses/non-taxable income	(0.50%)		(284)	0.23%		49
Reduced rate for active business and manufacturing and processing	(1.89%)		(1,081)	(1.81%)		(385)
Losses for which no deferred tax asset was recognized	(4.05%)		(2,314)	2.29%		487
Basis difference in subsidiary	0.00%		-	0.15%		32
Dividend withholding tax	0.84%		478	0.00%		–
Other	0.50%		287	0.55%		117
	21.58%	$	12,341	28.58%	$	6,074

Unrecognized temporary differences

At December 31, 2022, pre-tax temporary differences of $127,871,000 (2021 – $94,347,000) 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 $15,984,000 (2021– $11,793,000) based on current tax rates.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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

	December 31, 2022	December 31, 2021
Tax losses	$ 9,561	$ 13,529
Basis difference in subsidiary	30,688	32,831
Financial interests deductible in a future period	4,552	3,309
Provisions	1,201	549
	$ 46,002	$ 50,218

The financial interests deductible, provisions and $9,453,000 of tax losses carry forward indefinitely and relate to HPS S.p.A. and Continental Transformers s.r.l. The tax losses of $108,000 carry forward to 2023 and relate to Montran S.A. de C.V. 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	
	2022	2021	**2022**	2021
Property, plant and equipment	$ 1,166	$ 811	$ (3,539)	$ (3,552)
Intangible assets	415	91	(468)	(555)
Scientific research and experimental development	44	44	(17)	(36)
Inventories	653	225	–	–
Long-term lease	–	–	(3,832)	(3,402)
Loans and borrowings	1,833	1,950	–	–
Employee benefits	1,445	593	(161)	(159)
Unrealized losses (gains) on forward contracts and foreign denominated loans payable/receivable	184	274	(2)	(77)
Provisions and tax reserves	3,299	2,263	–	(4)
Tax loss carry-forwards	5,140	2,164	–	–
Basis difference in subsidiary	1,736	1,339	–	–
Tax assets (liabilities)	15,915	9,754	(8,019)	(7,785)
Set off of tax	(7,902)	(7,384)	7,902	7,384
Net tax assets (liabilities)	$ 8,013	$ 2,370	$ (117)	$ (401)

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

Movement in temporary differences during the year ended December 31, 2022:

	Balance December 31, 2021	Recognized in retained earnings	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2022
Property, plant and equipment	$ 2,741	$ (392)	$ 24	$ –	$ 2,373
Intangible assets	464	–	(411)	–	53
Scientific research and experimental development	(8)	–	(19)	–	(27)
Inventories	(225)	–	(428)	–	(653)
Long-term lease	3,402	–	430	–	3,832
Loans and borrowings	(1,950)	–	117	–	(1,833)
Employee benefits	(434)	–	(850)	–	(1,284)
Unrealized gains on forward contracts and foreign-denominated loans payable/receivable	(197)	–	15	–	(182)
Provisions and tax reserves	(2,259)	(255)	(785)	–	(3,299)
Tax loss carry-forwards	(2,164)	(1,799)	(1,177)	–	(5,140)
Basis difference in subsidiary	(1,339)	–	(397)	–	(1,736)
	$ (1,969)	$ (2,446)	$ (3,481)	$ –	$ (7,896)
Foreign exchange			$ 588		
Income tax expense			$ (2,893)		

Movement in temporary differences during the year ended December 31, 2021:

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

	Balance December 31, 2020	Recognized in retained earnings	Recognized in profit or loss	Recognized in other comprehensive income	Balance December 31, 2021
Property, plant and equipment	$ 3,226	$ –	$ (485)	$ –	$ 2,741
Intangible assets	637	–	(173)	–	464
Scientific research and experimental development	(12)	–	4	–	(8)
Inventories	(291)	–	66	–	(225)
Long-term lease	3,636	–	(234)	–	3,402
Loans and borrowings	(2,414)	–	464	–	(1,950)
Employee benefits	(180)	–	(254)	–	(434)
Unrealized gains on forward contracts and foreign-denominated loans payable/receivable	(130)	–	(67)	–	(197)
Provisions and tax reserves	(1,962)	–	(297)	–	(2,259)
Tax loss carry-forwards	(2,035)	–	(129)	–	(2,164)
Basis difference in subsidiary	(1,448)	–	109	–	(1,339)
	$ (973)	$ –	$ (996)	$ –	$ (1,969)
Foreign exchange			$ (40)		
Income tax expense			$ (1,036)		

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.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

(b) Issued:

		December 31, 2022	December 31, 2021
9,056,624	Class A subordinate voting shares (2021 – 9,011,624)	$ 15,233	$ 14,879
2,778,300	Class B common shares (2021 2,778,300)	7	7
11,834,924	Total A and B shares (2021 – 11,789,924)	$ 15,240	$ 14,886

During the year ended December 31, 2022, 45,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $298,000 and a transfer of $56,000 from contributed surplus. During the year ended December 31, 2021, 45,000 Class A shares were issued upon exercise of stock options, resulting in cash proceeds of $329,000 and a transfer of $66,000 from contributed surplus.

The following dividends were declared and paid by the Company:

	December 31, 2022	December 31, 2021
38.5 cents per Class A subordinate voting shares (2021 – 34 cents)	$ 3,486	$ 3,064
38.5 cents per Class B common shares (2021 – 34 cents)	1,070	945
	$ 4,556	$ 4,009

(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, 2022, or the year ended December 31, 2021. Options outstanding and exercisable as at December 31, 2022:

	December 31, 2022		December 31, 2021	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	115,000	$ 6.36	190,000	$ 6.77
Exercised	(45,000)	6.62	(45,000)	7.30
Cancelled	–	–	(10,000)	7.50
Expired	–	–	(20,000)	7.50
Outstanding, end of year	70,000	$ 6.20	115,000	$ 6.36

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

	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
$ 6.20	70,000	1	$ 6.20	70,000	$ 6.20

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 10, 2016	70,000	Board of Directors and Officers
Total stock options outstanding	70,000	

(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, 2021 and 2022 is as follows:

	Number of DSUs		Closing Share Price
Balance at January 1, 2021	160,534	$	8.47
DSUs issued	61,799		9.20
DSUs redeemed	(20,941)		7.41
Balance at December 31, 2021	201,392	$	11.99

	Number of DSUs		Closing Share Price
Balance at January 1, 2022	201,392	$	11.99
DSUs issued	44,152		12.49
DSUs redeemed	(31,569)		11.91
Balance at December 31, 2022	213,975	$	20.12

An expense of $2,183,000 (2021 – $1,210,000) was recorded in general and administrative expenses. The liability of $4,153,000 (2021 $2,346,000) related to these DSUs is included in accounts payable and accrued liabilities.

18. Earnings per share

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

		2022		2021
Basic earnings per share	$	3.79	$	1.29
Calculated as:				
Net earnings attributable to the equity holders of the Company	$	44,828	$	15,176
Weighted average number of shares outstanding		11,833,674		11,778,674
Fully diluted earnings per share	$	3.77	$	1.28
Calculated as:				
Net earnings attributable to the equity holders of the Company	$	44,828	$	15,176
Weighted average number of shares outstanding including effects of dilutive potential ordinary shares		11,876,359		11,824,822
Reconciliation of weighted average number of shares outstanding:				
Weighted average number of shares outstanding used to calculate basic earnings per share		11,833,674		11,778,674
Adjustment for dilutive effect of stock option plan		42,685		46,148
Weighted average number of shares outstanding used to calculate diluted earnings per share		11,876,359		11,824,822

As at December 31, 2022, nil options (2021 – nil) are excluded from the diluted average number of shares calculation as their effect would have been anti-dilutive.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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 $1,764,000 (2021 – of $1,748,000) matches the employee contributions. The Group's contributions related to its defined contribution pension plans are recorded as follows: $1,309,000 (2021 – $1,313,000) in cost of sales, $222,000 (2021 – $216,000) in selling and distribution, and $233,000 (2021 - $219,000) in general and administrative.

20. Provisions

	Warranties	Site restoration	Benefits and incentives	Total
Balance at January 1, 2021	$ 1,667	$ 231	$ 230	$ 2,128
Provisions made during the period	161	130	142	433
Provisions used during the period	(110)	(145)	(114)	(369)
Balance at December 31, 2021	$ 1,718	$ 216	$ 258	$ 2,192
Balance at January 1, 2022	$ 1,718	$ 216	$ 258	$ 2,192
Provisions made during the period	188	130	779	1,097
Provisions used during the period	(230)	(149)	(91)	(470)
Balance at December 31, 2022	$ 1,676	$ 197	$ 946	$ 2,819
Current portion	$ 1,676	$ 52	$ 112	$ 1,840
Non-current portion	$ –	$ 145	$ 834	$ 979

Warranties

The provision for warranties relates mainly to transformers sold during the years ended December 31, 2022 and December 31, 2021. The provision is based on estimates made from historical warranty data associated with similar products and claims experience. The Group expects to incur most of the liability over the next year.

Site restoration

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

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

Benefits and incentives

The benefit provision relates to statutory pension and leave benefits related to the India facility. Substantially all of this benefit is long-term. An incentive agreement dependent on revenue achievements was entered into in 2022 given Mesta's strong performance, scheduled to be paid in February 2024.

21. Sales and deferred revenue

Sales have been captured based on the geography of where the product was sold, as follows:

		2022		2021
Canada	$	184,495	$	130,184
United States and Mexico		349,710		231,738
India		24,259		18,280
	$	558,464	$	380,202

Movements in the Group's contract liabilities (deferred revenue) was as follows:

		2022		2021
Opening balance	$	5,027	$	204
Revenue recognized		(5,027)		(204)
Increase in contract liabilities		10,607		5,027
Ending balance	$	10,607	$	5,027

From time to time, the Company will require certain customers to advance payment prior to the satisfaction of performance obligations, which generally occurs at a point in time, upon the assumption of ownership of the transformer ordered by the customer.

22. Government assistance

During 2020 and 2021, the Government of Canada implemented the Canada Emergency Wage Subsidy program ("CEWS") that provided a subsidy of up to 75% of eligible remuneration paid by an eligible entity that experienced significant revenue declines due to the COVID-19 pandemic. In 2021, the Company has qualified for subsidy payments. The subsidy amounts relating to 2021 was recorded as a reduction in expenses as follows: cost of sales $2,482,000, selling and distribution $352,000 and general and administrative $649,000 for a total of $3,483,000.

No subsidy amounts were recorded in 2022.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

23. Related party transactions

Related parties

William G. Hammond, Chief Executive Officer and Chairman of the Company, directly and indirectly, through Arathorn Investments Inc., beneficially owns 2,778,300 (2021 – 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 924,802 (2021 – 921,808) Class A subordinate voting shares of the Company, representing approximately 10.2% (2021 – 10.2%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. William G. Hammond owns all of the issued and outstanding shares of Arathorn Investments Inc. Total dividends paid during the year, directly and indirectly to William G. Hammond were $1,432,000 (2021 – $1,283,000).

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:

		2022		2021
Salaries and benefits	$	3,499	$	3,511
Share-based awards		2,183		1,210
	$	5,682	$	4,721

24. Personnel expenses

		2022		2022
Wages and salaries	$	69,624	$	60,492
Group portion of government pension and employment pension and employment benefits		17,731		15,467
Contributions to defined contribution plans		1,763		1,748
	$	89,118	$	77,707

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

25. Change in operating working capital

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

		2022		2021
Accounts receivable	$	1,552	$	(18,836)
Inventories		(42,427)		(12,705)
Prepaid expenses and other assets		(870)		(666)
Accounts payable and accrued liabilities		13,038		24,526
Deferred revenue		5,580		4,823
Provisions		(470)		(369)
Settlement of derivatives		89		(1,952)
Foreign exchange		3,969		402
	$	(19,539)	$	(4,777)

26. 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 and India. Inter-segment sales are made at fair market value.

Geographic Segments		**2022**		2021
Sales				
Canada	$	184,495	$	130,184
United States and Mexico		349,710		231,738
India		24,259		18,280
	$	558,464	$	380,202
Property, plant and equipment and right-of-use assets – net				
Canada	$	15,458	$	15,091
United States		8,992		8,686
Mexico		12,718		3,439
India		4,574		3,744
	$	41,742	$	30,960
Investment in properties				
Canada	$	1,044	$	1,044
Italy		2,077		2,250
	$	3,121	$	3,294

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

		2022		2021
Investment in joint venture				
Mexico	$	-	$	13,279
Intangibles, net				
Canada	$	1,588	$	3,856
United States		4,400		4,664
India		1,662		1,983
	$	7,650	$	10,503
Goodwill				
Canada	$	2,180	$	2,180
United States		1,618		1,509
India		8,226		8,527
	$	12,024	$	12,216

27. 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 and contingent consideration issued in conjunction with a business combination. The forward foreign exchange contracts have a fair value of a liability of $276,000 as at December 31, 2022 (2021 – net asset of $89,000) and are included in Level 2 in the fair value hierarchy. To determine the fair value of the forward foreign exchange contracts, Management used a valuation technique in which all significant inputs were based on observable market data. The gains and losses from these contracts are grouped with foreign exchange gain on the statement of operations. The contingent consideration liability is valued at $2,846,000 as at December 31, 2022 (2021 - $1,509,000) and is included in Level 3 of the fair value hierarchy. There have been no transfers between levels in 2022 or 2021. The gains and losses from these contracts are grouped with foreign exchange gain on the statement of operations.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

The contingent consideration is comprised of three components:

		Employee performance		Revenue achievement		Deferred tax losses		Total
Current	$	616	$	–	$	–	$	616
Non-current		595		298		–		893
Balance at December 31, 2021	$	1,211	$	298	$	–	$	1,509
Current	$	672	$	–	$	837	$	1,509
Non-current		–		1,337		–		1,337
Balance at December 31, 2022	$	672	$	1,337	$	837	$	2,846

- Employee performance

  To determine the fair value of the contingent consideration, Management calculated the present value of the expected future payments of four installments of approximately $325,000, discounted using a risk-adjusted discount rate of 3.5%. Two of the payments were made starting January 2022 for a total of $651,000 paid to date. Management considers the risk of non-payment to be low. The estimated fair value would increase (decrease) if:

  - the risk-adjusted discount rate were lower (higher)

- Revenue achievement

  To determine the fair value of the contingent consideration, Management calculated the fair value of the liability based on the present value of the expected payment and a probability weighted formula, discounted using a risk-adjusted discount rate of 2.5%. Management considers the risk of repayment to be low. The estimated fair value would increase (decrease) if:

  - the risk-adjusted discount rate were lower (higher)

- Deferred tax asset – unused tax losses

  To determine the fair value of the contingent consideration, Management assessed the probability of realization of future tax losses based on the current year profitability of the entity and expected future forecasted earnings. It was determined that all available losses will be expected to be realized, for which the benefit component for National's 45% realization of certain tax losses. As of December 31, 2022 it was determined to be probable that sufficient future taxable profit will be available against which the unused tax losses can be recovered and utilized. The future tax asset value related to these losses was $1,861,000 and a corresponding liability to National of $837,000.

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 lease receivable is valued at the present value of the future receipts which approximates the fair value.

The employee performance and revenue achievement increases of $940,000 were recorded in general and administrative expenses. The deferred tax asset value of $837,000 was recorded in other expenses.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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, 2022, the Company had outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2023.

The employee performance and revenue achievement increases were recorded in general and administrative expenses. The deferred tax asset value was recorded in other expenses.

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	12,050	1.4485
BUY	EUR	USD	5,300	1.0700
BUY	USD	CAD	72,000	1.3374 - 1.3543
BUY	USD	INR	7,405	81.6400 – 82.5900
BUY	USD	MXN	16,467	19.5400
Buy/Sell	**Sell Currency**	**Buying Currency**	**Amount of Buy Currency**	**Traded Rate**
SELL	EUR	CAD	24,100	1.3942 – 1.4502
SELL	EUR	USD	10,600	1.0434 – 1.0715
SELL	USD	CAD	36,000	1.3538
SELL	USD	INR	3,689	82.4000
SELL	USD	MXN	21,500	19.5010 – 19.6200

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

At December 31, 2021, the Company has outstanding forward foreign exchange contracts to buy and sell the following contracts, all with maturity dates in January 2022.

Buy/Sell	Buy Currency	Selling Currency	Amount of Buy Currency	Traded Rate
BUY	EUR	CAD	12,050	1.4390
BUY	EUR	USD	5,300	1.1385
BUY	USD	CAD	68,500	1.2620 - 1.2652
BUY	USD	INR	8,477	74.7100 - 74.8800
BUY	USD	MXN	14,798	20.530
Buy/Sell	**Buy Currency**	**Selling Currency**	**Amount of Buy Currency**	**Traded Rate**
SELL	EUR	CAD	24,100	1.4288-1.4391
SELL	EUR	USD	10,600	1.1298 – 1.1385
SELL	USD	CAD	36,500	1.2614
SELL	USD	INR	4,257	74.4700
SELL	USD	MXN	29,000	20.6100 – 20.9530

As at December 31, 2022 the Group has recognized a net unrealized expense of $276,000 representing the fair value of these forward foreign exchange contracts, comprised of a liability of $276,000 included within accounts payable and accrued liabilities. As at December 31, 2021 the Group recognized a net unrealized gain of $89,000, comprised of an asset of $180,000 included with prepaid expenses and other assets, and a liability of $91,000 included within accounts payable and accrued liabilities.

Financial risk management:

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

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

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

Currency risk:

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

The following table represents the Group's balance sheet exposure to currency risk as at December 31, 2022:

	U.S. Dollars		Mexican Pesos		Euros		Indian Rupees	
	2022	2021	**2022**	2021	**2022**	2021	**2022**	2021
Cash	$ 12,023	$ 12,855	14,881	2,323	€ 675	€ 1,072	338,036	10,871
Accounts receivable	41,666	31,109	16,072	17,650	575	443	262,828	223,097
Long-term lease receivable	–	–	–	–	1,957	2,083	–	–
Bank operating lines of credit	–	(1,724)	–	–	(3,063)	(3,072)	–	–
Accounts payable	(18,003)	(23,226)	(16,464)	(14,265)	(160)	(18)	(346,452)	(223,205)
Lease obligation	(6,506)	(5,967)	–	–	–	–	(773)	(3,504)
Contingent consideration	(2,100)	(1,194)	–	–	–	–	–	–
Net exposure	$ (27,080)	$ 11,853	14,489	5,708	€ (16)	€ 508	253,639	7,259

A one cent ($0.01) decline in the Canadian dollar against the U.S dollar as at December 31, 2022 would have decreased net earnings by $487,000 and increased equity by $352,000. 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, 2022 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, 2022 would have decreased net earnings by $42,000 and impacted equity by $nil. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Euro as at December 31, 2022 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, 2022 would have increased net earnings and equity by $42,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Indian Rupee as at December 31, 2022 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, 2022 would have decreased net earnings by $14,000 and increased equity by $9,000. Inversely, a one cent ($0.01) increase in the Canadian dollar against the Peso as at December 31, 2022 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, 2022, 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' 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.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

During the year, the expected credit losses for trade accounts receivables increased $447,000 (2021 – decreased $218,000), for which an expense (2021 – recovery) was recognized in general and administrative expenses. The aging of accounts receivable and the related allowance is as follows:

	December 31, 2022		December 31, 2021	
	Gross	**Allowance**	**Gross**	**Allowance**
Not past due	$ 63,877	$ –	$ 48,820	$ –
Past due 0-30 days	20,035	–	18,716	–
Past due 31-120 days	3,505	716	5,963	1,495
Past due more than 120 days	2,090	2,090	864	864
	$ 89,507	$ 2,806	$ 74,363	$ 2,359

Credit risk:

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

	Carrying Amount	
	December 31, 2022	December 31, 2021
Cash and cash equivalents	$ 28,126	$ 20,905
Accounts receivable	86,701	72,004
Lease receivable	2,839	2,993
	$ 117,666	$ 95,902

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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

	Carrying Amount	
	December 31, 2022	December 31, 2021
Canada	$ 23,050	$ 25,097
United States	55,390	39,546
Mexico	7,705	1,257
Italy	553	334
India	3	5,770
	$ 86,701	$ 72,004

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, 2022 would increase or decrease net earnings by approximately $62,000 (2021 – $193,000) 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, 2022, no forward commodity purchase contracts were outstanding (2021 – 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.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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

December 31, 2022		**Carrying amount**		**1 year or less**		**1-2 years**		**2-5 years**
Bank operating lines of credit	$	6,154	$	6,154	$	–	$	–
Accounts payable and accrued liabilities		92,862		92,862		–		–
Contingent consideration		2,846		1,509		1,337		–
Derivative liabilities		276		276		–		–
	$	101,301	$	99,964	$	1,337	$	–

December 31, 2021		Carrying amount		1 year or less		1-2 years		2-5 years
Bank operating lines of credit	$	19,267	$	19,267	$	–	$	–
Accounts payable and accrued liabilities		70,642		70,642		–		–
Contingent consideration		1,509		616		595		298
Derivative liabilities		91		91		–		–
	$	91,509	$	90,616	$	595	$	298

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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

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

	LIABILITIES			EQUITY		
	Bank Operating Lines of Credit	Lease Liabilities	Contingent Consideration	Share Capital	Retained Earnings	Total
Balance January 1, 2022	$ 19,267	$ 7,980	$ 1,509	$ 14,886	$ 106,575	$ 150,217
Advances of bank operating lines of credit, net	(13,113)	–	–	–	–	(13,113)
Payment of contingent consideration	–	–	(651)	–	–	(651)
Interest payments	(1,596)	233	86	–	–	(1,277)
Exercise of stock options	–	–	–	298	–	298
Cash dividends paid	–	–	–	–	(4,556)	(4,556)
Repayment of lease liability	–	(3,004)	–	–	–	(3,004)
Total changes from financing cash flows	$ (14,709)	$ (2,771)	$ (565)	$ 298	$ (4,556)	$ (22,303)
Other changes						
Liability-related						
Interest expense	1,596	–	–	–	–	1,596
Foreign exchange	–	108	154	–	–	262
Non-cash additions to lease liabilities	–	3,199	–	–	–	3,199
Non-cash disposal to lease liabilities (note 10)	–	590	–	–	–	590
Non-cash disposal to lease liabilities (note 10)	–	(513)	–	–	–	(513)
Non-cash additions to contingent consideration (note 30)	–	–	1,748	–	–	1,748
Total liability-related other changes	$ 1,596	$ 3,384	$ 1,902	$ –	$ –	$ 6,882
Equity-related						
Exercise of stock options	–	–	–	56	–	56
Net income	–	–	–	–	44,828	44,828
Total equity-related other changes	$ –	$ –	$ –	$ 56	$ 44,828	$ 44,884
Balance December 31, 2022	$ 6,154	$ 8,593	$ 2,846	$ 15,240	$ 146,847	$ 179,680

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

	LIABILITIES			EQUITY		
	Bank Operating Lines of Credit	Lease Liabilities	Contingent Consideration	Share Capital	Retained Earnings	Total
Balance January 1, 2021	$ 16,073	$ 9,320	$ -	$ 14,491	$ 95,408	$ 135,292
Advances of bank operating lines of credit, net	3,194	–	–	–	–	3,194
Interest payments	(1,301)	254	–	–	–	(1,047)
Exercise of stock options	–	–	–	329	–	329
Cash dividends paid	–	–	–	–	(4,009)	(4,009)
Repayment of lease liability	–	(2,724)	–	–	–	(2,724)
Total changes from financing cash flows	$ 1,893	$ (2,470)	$ –	$ 329	$ (4,009)	$ (4,257)
Other changes						
Liability-related						
Interest expense	1,301	–	–	–	–	1,301
Foreign exchange	–	(65)	8	–	–	(57)
Non-cash additions to lease liabilities	–	1,195	–	–	–	1,195
Non-cash additions to contingent consideration (note 30)	–	–	1,501	–	–	1,501
Total liability-related other changes	$ 1,301	$ 1,130	$ 1,509	$ –	$ –	$ 3,940
Equity-related						
Exercise of stock options	–	–	–	66	–	66
Net income	–	–	–	–	15,176	15,176
Total equity-related other changes	$ –	$ –	$ –	$ 66	$ 15,176	$ 15,176
Balance December 31, 2021	$ 19,267	$ 7,980	$ 1,509	$ 14,886	$ 106,575	$ 150,217

28. 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, 2022.

For the years ended December 31, 2022 and 2021 (tabular amounts in thousands of dollars, except share and per share amounts)

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

	December 31, 2022	December 31, 2021
Cash and cash equivalents	$ 28,126	$ 20,905
Bank operating lines of credit	(6,154)	(19,267)
Lease liabilities	(8,593)	(7,980)
Contingent consideration	(2,846)	(1,509)
Share capital	15,240	14,886
Contributed surplus	2,376	2,432
Retained earnings	146,847	106,575
	$ 174,996	$ 116,042

29. Determination of fair values:

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

(a) Derivatives

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

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

(b) Non-derivative financial assets

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

(c) Share-based payment transactions

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

(d) Investment properties

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.

30. Acquisition:

On July 23, 2021, Hammond Power Solutions Inc. completed the acquisition of Mesta Electronics, Inc. ("Mesta") in the U.S., acquiring a 100% equity ownership. Mesta is involved in the design and manufacture of standard and custom active filter and induction heating products.

Mesta' annual revenues for 2019 and 2020 ranged from approximately $4,178,000 - $6,430,000.

Mesta not only expands HPS' U.S. presence but broadens our product offering and manufacturing capabilities in power quality solutions. Management feels that by building on the strengths of both companies, this acquisition will enhance HPS' market share, and performance going forward.

The purchase price has been allocated as follows:

Cash	$	256
Accounts receivable		90
Inventories and other assets		556
Property, plant and equipment		8
Intangibles (note 14)		5,084
Goodwill (note 12)		1,422
Assets	$	7,416
Current liabilities	$	(831)
Total purchase consideration	$	6,585

Satisfied as follows (in thousands of dollars):

Cash	$	5,032
Accounts payable		52
Contingent consideration		1,501
	$	6,585

The acquisition was accounted for using the purchase method whereby identified assets acquired and liabilities assumed were recorded at their estimated fair values as of the date of acquisition. The excess of the purchase price over such fair value was recorded as goodwill, which represents the expected synergies to be realized from Mesta's complementary products. The goodwill recognized is anticipated to be fully deductible for income tax purposes.

The transaction includes a contingent component for employee performance during the two years following the closing for up to $1,267,000 (2021 – $1,264,000). Two payments have been made under this component for a total of $651,000. The remaining liability has been valued at $672,000 (2021 – $1,205,000) and is due in two remaining quarterly installments of equal amounts payable to the remaining selling shareholders.

The transaction includes a second contingent consideration component of up to $1,337,000 (2021 – $1,257,500), payable 45 days after the third anniversary of the closing date. The liability payment is contingent on management achieving certain revenue targets, and has been recognized at $1,337,000 (2021 – $296,000), based on the Company's assessment of the likelihood of achievement of these targets.

Both contingent liabilities have been recorded as a liability as of December 31, 2022.

The acquisition costs incurred related to this transaction during 2021 were $174,000 which were included in general and administrative expense.

Included in the Group's consolidated results for the twelve months ended December 31, 2022, is revenue of $14,407,000 and net earnings of $7,365,000. Revenue of $1,042,000 and net earnings of $81,000 was recognized by Mesta from the date of acquisition to December 31, 2021. If the Company had acquired Mesta effective January 1, 2021, the revenue would have been approximately $1,865,000 and there would have been net loss of approximately $8,000. The revenue of the consolidated group would have been approximately $381,025,000 and net income of the consolidated group would have been $15,087,000.

31. Subsequent events

Dividends

On March 7, 2023, the Company declared a dividend of twelve and a half cents ($0.125) per Class A subordinate voting shares of HPS and a quarterly cash dividend of twelve and half cents ($0.125) per Class B common shares of HPS payable on March 30, 2023 to shareholders of record at the close of business on March 23, 2023. The ex-dividend date is March 22, 2023.

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
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10 Tawse Place
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795 Industriel Boul.
Granby, Quebec J2G 9A1

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

India

Hammond Power Solutions Private Limited
Plot No.6A, Phase-1, IDA Pashamylaram,
Patancheru Mandal, Sangreddy District,
Telangana, India 502307

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

Hammond Power Solutions Latin America 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

Mesta Electronics, Inc.
11020 Parker Drive,
North Huntington, Pennsylvania 15642

Annual General Meeting of Shareholders to be held:

Thursday, May 11, 2023
1:30 p.m. (EST)

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

Corporate Information

Corporate Officers and Directors

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

Richard C. Vollering
Corporate Secretary and
Chief Financial Officer

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
120 Victoria Street South,
Kitchener, ON N2G 0E1

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: David Feick, Investor Relations
Phone: 519.822.2441 x453
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 BEST WAY TO PREDICT THE FUTURE IS TO CREATE IT

Hammond Power Solutions Inc.

HAMMONDPOWERSOLUTIONS.COM