

Consolidated Statements of Financial Position

(unaudited)

(tabular amounts in thousands of dollars)

As at
July 2, 2016 December 31, 2015

Assets		
Current assets		
Cash	\$ 5,407	\$ 19,991
Accounts receivable	57,470	61,951
Inventories	43,980	43,549
Income taxes recoverable	1,959	662
Prepaid expenses and other assets	1,618	2,186
Total current assets	\$ 110,434	\$ 128,339
Non-current assets		
Property, plant and equipment (note 4)	\$ 42,444	\$ 45,225
Investment in properties	1,044	1,044
Investment in joint venture (note 5)	16,375	13,162
Deferred tax assets	2,038	1,735
Goodwill	18,488	19,606
Intangible assets (note 6)	12,556	13,858
Total non-current assets	92,945	94,630
Total assets	\$ 203,379	\$ 222,969
Liabilities		
Current liabilities		
Bank operating lines of credit (note 7)	\$ 32,811	\$ 29,166
Accounts payable and accrued liabilities	39,596	48,165
Income tax liabilities	—	3,089
Provisions	501	506
Derivative liabilities	125	261
Current portion of long-term debt (note 8)	3,813	4,027
Total current liabilities	\$ 76,846	\$ 85,214
Non-current liabilities		
Employee future benefits	\$ 416	\$ 389
Provisions	100	100
Long-term debt (note 8)	—	—
Deferred tax liabilities	5,147	4,965
Total non-current liabilities	5,663	5,454
Total liabilities	\$ 82,509	\$ 90,668
Shareholders' Equity		
Share capital (note 9)	13,843	13,843
Contributed surplus	2,568	2,434
Accumulated other comprehensive income (note 10)	10,262	18,492
Retained earnings	94,004	94,896
Total shareholders' equity attributable to equity holders of the Company	\$ 120,677	\$ 129,665
Non-controlling interests	193	2,636
Total shareholders' equity	120,870	132,301
Total liabilities and shareholders' equity	\$ 203,379	\$ 222,969

See accompanying notes to condensed consolidated interim financial statements

Consolidated Statements of Earnings

(unaudited)

(tabular amounts in thousands of dollars)	Quarter Ending		Six Months Ending	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Sales	\$ 69,138	\$ 65,384	\$ 137,860	\$ 128,521
Cost of sales	52,394	49,640	104,391	98,763
Gross margin	16,744	15,744	33,469	29,758
Selling and distribution	7,901	7,076	15,538	13,822
General and administrative	6,283	6,045	12,694	11,867
Earnings from operations	2,560	2,623	5,237	4,069
Finance and other costs				
Interest expense	326	264	527	380
Foreign exchange loss	19	476	340	186
Share of loss of investment in joint venture (note 5)	501	67	1,029	67
Other	33	33	66	66
Net finance and other costs	879	840	1,962	699
Earnings before income taxes	1,681	1,783	3,275	3,370
Income tax expense	1,164	687	1,874	1,493
Net earnings	\$ 517	\$ 1,096	\$ 1,401	\$ 1,877
Net earnings attributable to non-controlling interests	\$ (58)	\$ 93	\$ (21)	107
Net earnings attributable to equity holders of the Company	575	1,003	1,422	1,770
Net earnings	\$ 517	\$ 1,096	\$ 1,401	\$ 1,877
Earnings per share				
Basic earnings per share (dollars)	\$ 0.05	\$ 0.09	\$ 0.12	\$ 0.16
Diluted earnings per share (dollars)	\$ 0.05	\$ 0.09	\$ 0.12	\$ 0.16

See accompanying notes to condensed consolidated interim financial statements

DOLLARS IN THOUSANDS UNLESS OTHERWISE STATED

Consolidated Statements of Comprehensive Income

(unaudited)

(tabular amounts in thousands of dollars)	Quarter Ending		Six Months Ending	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Net earnings	\$ 517	\$ 1,096	\$ 1,401	\$ 1,877
Other comprehensive (loss) income				
Foreign currency translation differences for foreign operations	(1,913)	(2,200)	(8,236)	4,686
Other comprehensive income (loss) for the period, net of income tax (note 10)	(1,913)	(2,200)	(8,236)	4,686
Total comprehensive (loss) income for the period	\$ (1,396)	\$ (1,104)	\$ (6,835)	\$ 6,563
Attributable to:				
Equity holders of the Company	\$ (1,514)	\$ (1,117)	\$ (6,683)	6,320
Non-controlling interest	\$ 118	13	(152)	243
Total comprehensive (loss) income for the period	\$ (1,396)	\$ (1,104)	\$ (6,835)	\$ 6,563

See accompanying notes to condensed consolidated interim financial statements

Consolidated Statements of Changes in Equity

(unaudited) For the three months ended July 2, 2016

(tabular amounts in thousands of dollars)	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON- CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance, as at January 1, 2016	\$ 13,843	\$ 2,434	\$ 18,492	\$ 94,896	2,636	\$ 132,301
Total comprehensive income for the year						
Net earnings	—	—	—	1,422	(21)	1,401
Other comprehensive (loss) income						
Foreign currency translation differences (note 10)	—	—	(8,105)	—	(131)	(8,236)
Total other comprehensive loss	—	—	(8,105)	—	(131)	(8,236)
Total comprehensive (loss) income for the year	—	—	(8,105)	1,422	(152)	(6,835)
Transactions with shareholders, recorded directly in equity						
Minority interest (note 9)	—	—	(125)	(910)	(2,291)	(3,326)
Share-based payment transactions	—	134	—	—	—	134
Dividends to equity holders (note 9)	—	—	—	(1,404)	—	(1,404)
Total transactions with shareholders	—	134	(125)	(2,314)	(2,291)	(4,596)
Balance at July 2, 2016	\$ 13,843	\$ 2,568	\$ 10,262	\$ 94,004	\$ 193	\$ 120,870

*AOCI — Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements

Consolidated Statements of Changes in Equity

(unaudited) For the three months ended June 27, 2015

(tabular amounts in thousands of dollars)	SHARE CAPITAL	CONTRIBUTED SURPLUS	AOCI*	RETAINED EARNINGS	NON- CONTROLLING INTEREST	TOTAL SHAREHOLDERS' EQUITY
Balance, as at January 1, 2015	\$ 13,800	\$ 2,339	\$ 4,613	\$ 91,519	2,166	\$ 114,437
Total comprehensive income for the year						
Net earnings	—	—	—	1,770	107	1,877
Other comprehensive income						
Foreign currency translation differences (note 10)	—	—	4,550	—	136	4,686
Total other comprehensive income	—	—	4,550	—	136	4,686
Total comprehensive income for the year	—	—	4,550	1,770	243	6,563
Transactions with shareholders, recorded directly in equity						
Share-based payment transactions	—	95	—	—	—	95
Dividends to equity holders (note 9)	—	—	—	(1,403)	—	(1,403)
Total transactions with shareholders	—	95	—	(1,403)	—	(1,308)
Balance at June 27, 2015	\$ 13,800	\$ 2,434	\$ 9,163	\$ 91,886	\$ 2,409	\$ 119,692

*AOCI — Accumulated other comprehensive income

See accompanying notes to condensed consolidated interim financial statements

Consolidated Statements of Cash Flows

(unaudited)

(tabular amounts in thousands of dollars)	Six Months Ending	
	July 2, 2016	June 27, 2015
Cash flows from operating activities		
Net earnings	\$ 1,401	\$ 1,877
Adjustments for:		
Share of loss of investment in joint venture	1,029	—
Amortization of property, plant and equipment	2,563	2,295
Amortization of intangible assets	1,023	947
Provisions	(5)	104
Interest expense	527	380
Income tax expense	1,874	1,493
Change in unrealized gain on derivatives	(136)	(22)
Stock based compensation expense	134	95
	8,410	7,169
Change in non-cash working capital (note 12)	(10,471)	(5,424)
Cash used in operating activities	(2,061)	1,745
Income tax paid	(6,260)	(864)
Net cash (used in) provided by operating activities	(8,321)	881
Cash flows from investing activities		
Minority interest	(3,326)	—
Investment in joint venture (note 5)	(4,155)	(5,023)
Acquisition of property, plant and equipment	(1,012)	(432)
Acquisition of intangible assets	(217)	(187)
Cash used in investing activities	(8,710)	(5,642)
Cash flows from financing activities		
Advances of borrowings	3,645	8,565
Repayment of long-term debt	(44)	(161)
Cash dividends paid (note 8)	(1,404)	(1,403)
Interest paid	(527)	(380)
Cash provided by financing activities	1,670	6,621
Foreign exchange on cash held in a foreign currency	777	(522)
(Decrease) increase in cash	(14,584)	1,338
Cash and cash equivalents at beginning of period	19,991	6,456
Cash and cash equivalents at end of period	\$ 5,407	\$ 7,794

See accompanying notes to condensed consolidated interim financial statements

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

1. Reporting entity

Hammond Power Solutions Inc. (“HPS” or the “Company”) is a company domiciled in Canada. The address of the Company's registered office is 595 Southgate 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 Condensed Consolidated Interim Financial Statements of the Company as at and for the second quarter ended July 2, 2016 comprise the Company and its subsidiaries (together referred to as the “Group” and individually as “Group entities”) and the Group's interest in associates and jointly controlled entities. The Group is primarily involved in the design and manufacture of custom electrical magnetics, cast resin, custom liquid filled distribution and power transformers and standard electrical transformers, serving the electrical and electronic industries. The Company has manufacturing plants in Canada, United States (“U.S.”), Mexico, Italy, and India, the latter being PETE Hammond Power Solutions Private Limited (“PETE”), a subsidiary in which the Company holds a 85% equity ownership. On October 31, 2014, the Company executed a joint venture agreement with National Material L.P. for the manufacturing of transformer cores. On March 25, 2015, the Company and National Material L.P. completed the formation of the joint venture and a new company Corefficient S. de R.L. de C.V. (“Corefficient”) was established, in which HPS holds a 55% partnership interest.

2. Basis of preparation

(a) Statement of compliance

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

These condensed consolidated interim financial statements were approved by the Board of Directors on August 8, 2016.

(b) Use of estimates and judgments

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

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

In preparing these condensed consolidated interim financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2015.

3. Summary of significant accounting policies:

These condensed consolidated interim financial statements should be read in conjunction with the Group's 2015 annual audited financial statements, which are available on the System for Electronic Document Analysis and Retrieval (“SEDAR”). The significant accounting policies applied by the Company in these condensed consolidated interim financial statements are the same as those applied by the Company in its Consolidated Financial Statements as at and for the year ended December 31, 2015.

Changes to accounting policies

Interests in joint operations

On May 6, 2014, the International Accounting Standards Board (“IASB”) issued amendments to IFRS 11, Accounting for Acquisitions of Interests in Joint Operations. The amendments require business combinations accounting to be applied to acquisitions of interests in a joint operation that constitute a business. The Company adopted the amendments to IFRS 11 in its consolidated financial statements for the year commencing January 1, 2016. The adoption of the amendment did not have a material impact on the consolidated financial statements.

Transfer of assets

On September 11, 2014 the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28). The amendments apply prospectively for annual periods beginning on or after January 1, 2016. The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011) in dealing with the sale or contribution of assets between an investor and its associate or joint venture (JV). Specifically, under the existing consolidation standard the parent recognizes the full gain on the loss of control, whereas under the existing guidance on associates and JVs the parent recognizes the gain only to the extent of unrelated investors' interests in the associate or JV. The main consequence of the amendments is that a full gain/loss is recognized when the assets transferred meet the definition of a 'business' under IFRS 3 Business Combinations. A partial gain/loss is recognized when the assets transferred do not meet the definition of a business, even if these assets are housed in a subsidiary. The Company adopted these amendments in its consolidated financial statements for the year commencing January 1, 2016. The adoption of the amendment did not have a material impact on the consolidated financial statements.

Annual improvements to IFRS (2012 – 2014) cycle

On September 25, 2014 the IASB issued narrow-scope amendments to a total of four standards as part of its annual improvements process. The amendments will apply for annual periods beginning on or after January 1, 2016. Earlier application is permitted, in which case, the related consequential amendments to other IFRSs would also apply. Each of the amendments has its own specific transition requirements.

Amendments were made to clarify the following in their respective standards:

- Changes in method for disposal under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
- 'Continuing involvement' for servicing contracts and offsetting disclosures in condensed interim financial statements under IFRS 7 Financial Instruments: Disclosures;
- Discount rate in a regional market sharing the same currency under IAS 19 Employee Benefits;
- Disclosure of information 'elsewhere in the interim financial report' under IAS 34 Interim Financial Reporting;

The Company adopted these amendments in its consolidated financial statements for the year commencing January 1, 2016. The adoption of the amendment did not have a material impact on the consolidated financial statements.

Disclosure initiative

On December 18, 2014 the IASB issued amendments to IAS 1 Presentation of Financial Statements as part of its major initiative to improve presentation and disclosure in financial reports (the "Disclosure Initiative"). The amendments are effective for annual periods beginning on or after 1 January 2016. Early adoption is permitted. These amendments will not require any significant change to current practice, but should facilitate improved financial statement disclosures. The Company adopted these amendments in its financial statements for the year commencing January 1, 2016. The adoption of the amendment did not have a material impact on the consolidated financial statements.

4. Property, plant and equipment

The Group had acquisitions of fixed assets for the six months ended July 2, 2016 in the amount of \$1,012,000 of machinery and equipment (2015 - \$432,000).

5. Joint venture

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

	July 2, 2016
Cost of investment in joint venture	\$ 18,252
Share of loss in investment in joint venture	(1,877)
	<u>\$ 16,375</u>

Selected financial information relating to Corefficient is as follows:

	July 2, 2016
Cash	\$ 228
Trade and other receivables	7,688
Inventories	1,516
Other current assets	458
Total current assets	\$ 9,890
Non-current assets	19,034
Total assets	\$ 28,924
Current liabilities	\$ 1,885
Non-current liabilities	\$ —
Total liabilities	\$ 1,885
	Six Months Ending July 2, 2016
Revenue	\$ 9,540
Loss for the year	\$ 1,867

The loss for the six months ended July 2, 2016 includes depreciation and amortization expense of \$1,120,000, interest expense of \$3,000 and an income tax recovery of \$788,000 related to Corefficient.

6. Intangible assets

The Group had acquisitions of intangible assets for the six months ended July 2, 2016 in the amount of \$217,000 (2015 - \$187,000), for the addition of software. None of the intangible assets have been developed internally.

7. Bank operating lines of credit

The Company entered into a new banking agreement during the quarter, which expires in July, 2020, consists of a \$35,000,000 U.S. revolving credit facility, a \$5,000,000 U.S. overdraft facility, a 4,000,000 Euro overdraft facility, a 110,000,000 Indian rupees overdraft facility and a \$10,000,000 U.S. delayed draw credit facility. The Company also has access to 70,000 Euro and 160,000,000 Indian rupees letters of credit. Based on exchange rates in effect at July 2, 2016, the combined Canadian dollar equivalent available prior to any utilization of the facilities was \$75,544,000. The delayed draw facility does not charge any fees on the unutilized balance until the facility is used. The initial use of the facility needs to be approved by the bank. The facilities are unsecured.

8. Long-term debt

	Six Months Ending	
	July 2, 2016	June 27, 2015
Opening balance	\$ 4,027	\$ 4,111
Repayments		
Term loan CAD	(44)	(91)
Term Loans EUR	—	(63)
Term loan INR	—	(7)
Exchange	(170)	(71)
	3,813	3,879
Less current portion of long-term debt	3,813	3,879
Total	\$ —	\$ —

9. Share capital

(a) Dividends

The following dividends were declared and paid by the Company:

	Six Months Ending	
	July 2, 2016	June 27, 2015
12 cents per Class A common share (2015: 12 cents)	\$ 1,070	\$ 1,069
12 cents per Class B common share (2015: 12 cents)	334	334
	\$ 1,404	\$ 1,403

(b) Stock option plan

During the six months ended July 2, 2016, the Company granted 160,000 options (2015 – 95,000) of which 115,000 vested immediately (2015 – 55,000). Stock-based compensation recognized the amount credited to contributed surplus during the period, is \$134,000 (2015 - \$95,000) and relates to options granted during Quarter 1, 2016, and to options granted in prior years that vested during the period. The weighted average fair value of the options granted during the period is \$0.96 (2015 - \$1.26).

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

	2016	2015
Fair value of share options and assumptions		
Fair value at grant date	\$ 0.96	\$ 1.26
Share price at grant date	\$ 6.20	\$ 6.62
Exercise price	\$ 6.20	\$ 6.62
Expected volatility (weighted average volatility)	39.4%	41.3%
Option life (expected weighted average life)	3.8 years	3.8 years
Expected dividends	3.6%	3.6%
Risk-free interest rate (based on government bonds)	1.4%	1.6%

(c) Purchase of Minority Interest

On March 5, 2016, HPS signed an agreement to acquire the shares of K. Linga Reddy, a minority shareholder of PETE in India, acquiring an additional 15% equity ownership of its transformer business for 172,625,181 Indian Rupees (approximately \$3,326 CAD). The Company completed the transaction on April 21, 2016. This increases HPS's equity ownership of PETE to 85%. The impact of this transaction was a reduction in minority interest in the amount of \$2,291, a decrease in accumulated other comprehensive income in the amount of \$125 and a reduction in retained earnings in the amount of \$910.

10. Accumulated Other Comprehensive Income

Changes to the accumulated other comprehensive income ("AOCI") balance include foreign currency translation differences relating to the net assets of foreign operations. Total other comprehensive loss for the six months ended July 2, 2016 was \$8,105,000 (2015 comprehensive income – \$4,550,000), resulting in an ending balance of accumulated other comprehensive income of \$10,262,000 (2015 – \$9,163,000).

11. Related party transactions

Related parties

Arathorn Investments Inc. beneficially owns 2,778,300 (2015 – 2,778,300) Class B common shares of the Company, representing 100% of the issued and outstanding Class B common shares of the Company and 1,053,767 (2015 – 1,050,921) Class A subordinate voting shares of the Company, representing approximately 11.8% (2015 – 11.8%) of the issued and outstanding Class A subordinate voting shares of the Company and as a result controls the Company. William G. Hammond, Chief Executive Officer and Chairman of the Company, owns all of the issued and outstanding shares of Arathorn Investments Inc. Total dividends paid during the quarter, directly and indirectly to William G. Hammond were \$230,000 (Quarter 2 2015 – \$230,000).

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

	Note	2016	2015	Relationship
Purchase of goods and services	(i)	\$ 719	\$ 512	Companies in which key management personnel and/or their relatives have significant influence.

		2016	2015	Relationship
Amounts owed by related parties		\$ 458	\$ 196	Companies in which key management personnel and/or their relatives have significant influence.

Transactions with key management personnel

During the six months ended July 2, 2016, the Company purchased \$131,000 (2015 – \$122,000) of inventory from ILSCO of Canada Limited ("ILSCO"), a company in which HPS director David J. FitzGibbon serves as a Vice Chairman and CEO. The Company purchases a component part from ILSCO, which is utilized in the manufacture of transformers. The purchases were measured at the exchange amount. Accounts payable and accrued liabilities include \$29,000 (2015 – \$13,000), which is owed to this company.

(i) During the six months ended July 2, 2016, the Company has paid \$7,000 (2015 – \$10,000) of payments in connection with rental agreements for office space and an apartment with K. Ravi Reddy, the minority shareholder of PETE – Hammond Power Solutions Private Limited in India

12. Change in non-cash operating working capital

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

	Six Months Ending	
	July 2, 2016	June 27, 2015
Accounts receivable	\$ 4,481	\$ (5,086)
Inventories	(431)	(3,956)
Prepaid expenses	568	(49)
Accounts payable and accrued liabilities	(8,569)	(747)
Foreign exchange	(6,520)	4,414
	\$ (10,471)	\$ (5,424)