DIRTT announces second quarter 2019 results

Company also announces appointment of chief commercial officer

CALGARY, Alberta, July 30, 2019 -- DIRTT Environmental Solutions Ltd. ("DIRTT" or the "Company") (TSX: DRT), an interior construction company that uses technology for client-driven design and manufacturing, today announced its financial results for the three months ended June 30, 2019. All financial information in this news release is in Canadian dollars, unless otherwise stated.

SECOND QUARTER 2019 VS. SECOND QUARTER 2018

- Revenue of $85.6 million vs. $80.7 million (up 6%)
- Gross profit percentage of 41.4% vs. 40.6%
- Adjusted Gross Profit percentage[1] of 43.1% vs. 43.0%
- Operating expenses of $29.1 million[2] vs. $31.0 million
- Adjusted Operating Expenses[1,3] of $27.1 million vs. $26.6 million
- Adjusted EBITDA[1,3] of $9.1 million vs. $8.2 million
- Adjusted EBITDA percentage[1,3] of 10.7% vs. 10.1%
- Net income of $3.0 million[3] or $0.03 per share vs. net income of $0.8 million or $0.01 per share

Note: (1) See "Non-IFRS Measures".

(2) Includes $2.2 million recovery of stock-based compensation expenses.

(3) In the current quarter, Adjusted EBITDA and Adjusted Operating Expenses were impacted by the prospective adoption of a new accounting standard for operating leases, which had the impact of increasing depreciation by $1.4 million and finance costs by $0.3 million with a corresponding reduction in rent expense. The change in accounting policy increased 2019 Adjusted EBITDA by $1.7 million, or 2.0% of revenue, and decreased Adjusted operating expenses by $1.7 million over the comparable 2018 period.

COMMENTARY FROM KEVIN O'MEARA, CHIEF EXECUTIVE OFFICER

We are pleased to announce the successful conclusion of DIRTT's comprehensive search for a chief commercial officer, a role that was created for the purpose of leading our sales and marketing transformation to drive aggressive growth. We will announce our successful candidate's name in the coming weeks, in order to allow her former company time to manage the transition of her responsibilities. Her expected start date is in the late third quarter. Our new CCO has most recently served as an executive vice president at a multi-billion dollar, publicly traded enterprise software company with a global footprint, leading product marketing, product management, marketing and sales. She is an accomplished executive with proven expertise in driving business-to-business sales and marketing programs at a company that goes to market via a value-added distribution partner network with an offering that has long sales cycles, similar to DIRTT. We look forward to sharing further details on our CCO in the coming weeks.

In another significant step forward, we are planning to establish a new manufacturing facility in the southeastern US, with commitments to purchase equipment beginning in the third quarter of this year. This new factory fulfills three critical needs: first, it ensures sufficient capacity is available to allow our sales force and distribution partners to sell with confidence to drive growth; second, it eliminates single plant risk; third, it provides better currency-matching of the costs of production with the associated sales. We have conducted a comprehensive analysis of potential locations, including the proximity of commercial real estate markets and customers, labor availability, logistics costs, and sources of raw materials and narrowed the location to two potential sites. We expect to announce our final decision later this year. We expect this factory to be operational in the first quarter of 2021. We anticipate total capital costs of the facility to be US$18.5 million, which we expect to fund with cash on hand.

We are also pleased to announce a permanent solution to the incidence of post-delivery tile warping that was caused by regulatory-driven composition changes to the MDF substrate we use and as discussed in last quarter reporting. The solution involves applying a primer coating on both sides of the MDF, which will result in significantly less moisture absorption than unprimed MDF. This method is being implemented in two phases. The first is that we will initially source the primed MDF from a third party, while we acquire and install the necessary equipment to self-prime the MDF (phase two). We expect total equipment and installation costs to be $2.6 million, with anticipated commissioning in the first quarter of 2020. For the remainder of 2019 and until commissioning of this equipment, we expect that costs for MDF will be commensurate with those incurred in the first two quarters of 2019.

Second quarter revenue growth of 6% was consistent with our expectations. Gross profit increased 8%, compared to the same period in 2018, on higher revenue and the realization of modest improvements in operating efficiencies in our manufacturing facilities. These improvements were partially offset by residual tile deficiency costs of $0.7 million and $0.9 million of incremental costs attributable to certain installations that were sold on fixed price contracts by prior management.

Adjusted EBITDA was $9.1 million compared to $8.2 million in 2018, and included the $1.7 million positive effect of the new leasing standard that was adopted prospectively in 2019. This change reflects higher gross profit for the reasons mentioned above and is offset by slight increases in adjusted operating expenses that were partly attributable to the management consulting engagement and US listing costs discussed in the prior quarter.

In July, we replaced our US$18 million undrawn revolving credit facility that expired on June 30, 2019, with a $50 million three-year committed revolving credit facility with Royal Bank of Canada, of which $40 million is available until certain post-closing conditions are cleared. Management believes that the combination of cash on hand, expected cashflow from operations and this new facility will provide sufficient financial capacity to fund future foreseeable capital requirements.

We also continue to progress toward the anticipated listing of DIRTT's common shares on the Nasdaq Stock Market. In preparation, management has completed the conversion of the Company's financial statements to US GAAP with a US dollar presentation currency and has also performed an in-depth assessment of its governance policies and related documentation to comply with US securities standards. We anticipate the listing to occur this fall.

Looking to the balance of the year and based on current visibility, DIRTT's management team reaffirms an annual revenue guidance range of 5% to 10%, with an expectation that we will be at the lower end of that range for the full year. This is due to the timing of some projects now anticipated to deliver in early 2020.

DIRTT's chairman of the board, Steve Parry, also announced that effective at the Company's next board meeting in November 2019, board member Richard Haray would retire from the board. Mr. Haray has served as a board member since 2016. "We've been fortunate to have Richard serve on DIRTT's board for the past three years and we're particularly appreciative of his active role in assisting DIRTT through last year's management changes," said Parry. "We extend our gratitude and best wishes to Richard and his family."

SECOND QUARTER FINANCIAL REVIEW

Revenue

Revenue growth of 6% in the second quarter over the prior year period was driven primarily by a weaker Canadian dollar and increased education sales. Combined with modest growth in the commercial segment and increased installation activity, this increase was partially offset by lower healthcare sales, which reflect the timing of projects and modest reductions in government sales.

Gross Profit / Gross Profit % / Adjusted Gross Profit / Adjusted Gross Profit %

Gross profit increased to $35.5 million or 41.4% of revenue for the three months ended June 30, 2019, from $32.8 million or 40.6% of revenue for the same period of 2018. During the quarter, DIRTT began to realize the benefits of operational improvement activities in its manufacturing facilities. Reductions in direct material and transportation costs—due to improved efficiency and product mix—offset the incremental costs of $0.7 million (0.8% of gross profit) to mitigate further warping of DIRTT's tiles, $1.3 million of costs associated with headcount additions throughout 2018 in anticipation of higher volumes, and a $0.9 million reduction in gross profit on certain uneconomic installation projects.

Adjusted Gross Profit and Adjusted Gross Profit % increased to $36.8 million or 43.1% of revenue in the second quarter of 2019, from $34.7 million or 43.0% of revenue in the same period of 2018, for the reasons described above.

Operating Expenses / Adjusted Operating Expenses

Adjusted Operating Expenses exclude the impact of depreciation, stock-based compensation and reorganization costs. Adjusted Operating Expenses increased $0.5 million to $27.1 million in the second quarter of 2019, compared to $26.6 million in the second quarter of 2018. Adjusted Operating Expenses were impacted by the prospective adoption of a new accounting standard for operating leases. The change in accounting policy decreased Adjusted Operating Expenses by $1.7 million, as $1.4 million of increased depreciation was subtracted in the calculation of Adjusted Operating Expenses and $0.3 million was classified as finance costs.

Sales and marketing expenses

Sales and marketing expenses decreased $0.3 million to $12.8 million for the three months ended June 30, 2019, from $13.0 million for the three months ended June 30, 2018. Included in sales and marketing expenses in the second quarter was $1.7 million of consulting costs related to the sales and marketing consulting engagement, as described last quarter. These costs were absorbed by continued reductions in travel, meals and entertainment costs, along with reductions related to specific trade shows. None of these expense reductions are expected to impact sales revenue.

General and administrative expenses

General and administrative expenses decreased $1.1 million to $8.9 million for the three-months ended June 30, 2019, from $10.1 million for the same period in 2018. In the second quarter of 2018, the Company incurred $1.2 million related to proxy defense costs, which did not recur in 2019. This reduction was partially offset by $0.5 million of costs related to the US listing that were incurred in the second quarter of 2019.

Operations support expenditures

Operations support expenditures increased $1.3 million to $5.9 million for the three-month period ended June 30, 3019, from $4.6 million for the same period in 2018. Included in operations support expenditures in the second quarter was $0.9 million of consultant costs, which were incurred to assist with the evaluation of current operations and the rectification of the tile warping issue. Additionally, personnel costs increased due to team additions and an increased provision for variable compensation.

Technology and development expenses
Technology and development expenses increased $1.7 million to $3.6 million for the three months ended June 30, 2019 from $1.9 million for the three months ended June 30, 2018. This is due to a $0.7 million decrease in capitalized salaries for the quarter, as the current mix of projects undertaken by the team included a higher portion of efforts related to business process improvements that weren't eligible for capitalization. Additionally, the Company has provided $0.4 million higher provision for variable compensation in the current year, and in 2018, $0.4 million additional salary and benefit costs were classified as cost of sales of technical services.

Stock-based compensation
Stock-based compensation reflected a $2.2 million recovery in the second quarter of 2019 (2018 - $0.3 million expense). The Company recorded fair value adjustments on cash settled stock options during the three-month period ended June 30, 2019, with no fair value adjustment in the respective prior year periods.

The fair value adjustment was a result of the cash surrender feature put in place for employee stock options, subsequent to the Company ceasing to qualify as a foreign private issuer. Once a US registration statement is filed and accepted by the Securities Exchange Commission, the Company will cease accounting for the fair value of the outstanding stock options.

The Company incurred no reorganization costs in the second quarter of 2019.

Adjusted EBITDA / Adjusted EBITDA %
For three months ended June 30, 2019, Adjusted EBITDA increased to $9.1 million or 10.7% of revenue, from $8.2 million or 10.1% of revenue in the same period of 2018. This increase reflects the $2.1 million increase in Adjusted Gross Profit, increases in Adjusted Operating Expenses of $0.5 million that included the impacts of the sales and marketing consulting engagement, US listing costs, and other one-time costs noted previously, the $1.7 million benefit of the new accounting standard for leases discussed above, and a $0.5 million impact of foreign exchange losses.

Net income / Adjusted Net Income
Net income was $3.0 million or $0.03 per share in the second quarter of 2019, compared to net income of $0.8 million or $0.01 per share for the second quarter of 2018. This variance is the result of changes in gross margin and operating expenses as described above. Net income for the three months ended June 30, 2019 includes the impact of a $2.2 million recovery (2018 - $0.3 million expense) in stock-based compensation and $nil (2018 - $1.0 million) of reorganization costs. Excluding these items, Adjusted Net Income was a $0.4 million loss or $nil per share for the second quarter of 2019, an increase from $1.5 million Adjusted Net Income or $0.02 per share in the second quarter of 2018.

Liquidity and Capital Resources
As at June 30, 2019, the Company held cash and cash equivalents of $76.9 million, an increase of $4.0 million from December 31, 2018. In July 2019, the Company entered into a $50 million revolving operating facility with the Royal Bank of Canada (of which $40 million is available until certain post-closing conditions are cleared), replacing the US$18 million revolving operating facility that expired June 30, 2019. Management believes that existing cash and cash equivalents, cash flows from operations and available borrowings under its credit facility will be sufficient to support working capital and capital expenditure requirements for the foreseeable future.

Capital expenditures decreased by $2.7 million for the three months ended June 30, 2019, of which $0.7 million relates to a reduction in capital expenditures on internally generated intangible assets. The level of capitalizable activity decreased comparatively, as 2018 included significant internal efforts on the DIRTT Timber and DIRTT for Life development activities which were curtailed in the second half of 2018. Additionally, a portion of the ICE software development team's current development activities includes projects related to business process improvements that are not eligible for capitalization.

Conference Call and Webcast Details
A conference call and webcast for the investment community is scheduled for Wednesday, July 31, 2019, at 8:00 a.m. MDT (10:00 a.m. EDT). The call and webcast will be hosted by Kevin O'Meara, chief executive officer; Geoff Krause, chief financial officer; and Kim MacEachern, director of investor relations.

To join by telephone, dial +1-877-479-7708 (toll-free in North America) or +1-647-427-2478 (international). Please dial in 10 minutes prior to the start time. For the live webcast (in listen-only mode) visit https://edge.media-server.com/mmc/p/857j9x25.

Investors are invited to submit questions to ir@dirtt.net before and during the call. Supplemental information slides will be available with the webcast, and at dirtt.net/investors prior to the call start.

A replay of the call and webcast will be available from 11:00 a.m. MDT (1:00 p.m. EDT) on July 31, 2019 until 9:59 p.m. MDT (11:59 p.m. EDT) on August 7, 2019:

- By phone at +1-855-859-2056 with passcode 9981218;
- Online at https://edge.media-server.com/mmc/p/857j9x25; and
- On DIRTT's website at dirtt.net/financial-reports.

About DIRTT
DIRTT is a building process powered by technology. The name stands for Doing It Right This Time. The company uses its proprietary ICE® software to design, manufacture and install fully customized interior environments. The technology drives

DIRTT's advanced manufacturing and provides certainty on cost, schedule and the final result. Complete interior spaces are constructed faster, cleaner and more sustainably. DIRTT's manufacturing facilities are located in Phoenix, Savannah and Calgary. DIRTT works with nearly 100 sales partners globally and trades on the Toronto Stock Exchange under the symbol "DRT." For more information visit dirtt.net/investors.

Non-IFRS Measures

The term "Adjusted Gross Profit", "Adjusted Gross Profit %", "Adjusted Operating Expenses", "Adjusted EBITDA", "Adjusted EBITDA %", "Adjusted Net Income" and "Net cash flows provided by operating activities before changes in non-cash working capital" are financial measures used by DIRTT that are not standard measures under International Financial Reporting Standards ("IFRS") as adopted by the Canadian Institute of Chartered Accountants. DIRTT's method of calculating Adjusted Gross Profit, Adjusted Gross Profit %, Adjusted Operating Expenses, Adjusted EBITDA, Adjusted EBITDA %, Adjusted Net Income and Net cash flows provided by operating activities before changes in non-cash working capital may differ from the methods used by other issuers. Therefore, these non-IFRS measures may not be comparable to the same measures presented by other issuers.

Adjusted Gross Profit is gross profit before deductions for depreciation and amortization of equipment, tooling and intangible assets for manufacturing-related assets. Adjusted Gross Profit % is Adjusted Gross Profit divided by revenue. We use these measures to assess our manufacturing and operating performance. As manufacturing volumes and revenue rise, production synergies tend to permit improvements in gross profit, subject to variability in monthly manufacturing volumes and product/service revenue mix.

Adjusted Operating Expenses is Operating Expenses before deductions for depreciation and amortization of non-manufacturing related assets, stock-based compensation expenses and reorganization costs. We use this as a measure of the efficiency and effectiveness of our sales and marketing efforts and overall administrative support efforts by comparing them to prior period results.

Adjusted EBITDA is net income before interest, taxes, depreciation and amortization, plus: non-cash foreign exchange gains or losses on debt revaluation; stock-based compensation expenses; reorganization costs; and any other non-recurring gains or losses. Adjusted EBITDA % is calculated as Adjusted EBITDA divided by revenue. We use these measures as a performance measure as they are widely used by securities analysts and investors to evaluate financial performance, as well we use these measures to assess our ability to generate cash flows, service debt, pay current taxes and fund capital expenditures.

"Adjusted Net Income" is net income (loss) excluding the tax effected impact of reorganization costs and stock-based compensation fair value adjustment.

"Net cash flows provided by operating activities before changes in non-cash working capital" are net cash flows provided by operating activities and adding back the change in non-cash working capital.

For a reconciliation of these non-IFRS measure see DIRTT's annual and interim Management Discussion and Analysis, complete copies of which are available on the Company's website at www.dirtt.net and on SEDAR at www.sedar.com.

Special Note Regarding Forward-Looking Statements

Certain information and statements contained in this news release constitute "forward-looking information" and "forward-looking statements" (collectively, "Forward-Looking Information") as defined under applicable Canadian securities laws and the Company hereby cautions investors about important factors that could cause the Company's actual results or outcomes to differ materially from those projected in any Forward-Looking Information contained in this news release. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "will likely result", "are expected to", "will continue", "is anticipated", "believes", "estimated", "intends", "plans", "projection" and "outlook"), are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such Forward-Looking Information. In particular and without limitation, this news release contains Forward-Looking Information pertaining to the following: comments with respect to the Company's revenue, objectives and priorities for 2019 and beyond; project timetables; its growth strategies and opportunities; its ability to meet working capital requirements and financial obligations; use and deployment of the Company's capital; and its outlook for its operations and the Canadian, US and international economies, and in particular, the US and Canadian construction industry.

With respect to Forward-Looking Information contained in this news release, assumptions have been made regarding the Company, among other things:

- its ability to manage its growth;
- competition in its industry;
- its ability to enhance current products and develop and introduce new products;
- its ability to obtain components and products from suppliers on a timely basis and on favorable terms;
- its ability to obtain qualified staff and equipment in a timely and cost-efficient manner;
- the regulatory framework governing taxes in Canada and the US and any other jurisdictions in which the Company currently or may conduct its business in the future;
- future development plans for its assets unfolding as currently envisioned;
- future capital expenditures to be made by the Company;
- future sources of funding for its capital program;
- its ability to list on an accredited US exchange;

- the impact of increasing competition on the Company; and
- its success in identifying risks to its business and managing the risks mentioned below.

The Company's actual results or outcomes could differ materially from those expressed in the Forward-Looking Information as a result of the risks normally encountered in its industry such as:

- risks related to additional capital requirements;
- fluctuations in commodity prices;
- credit risks;
- foreign exchange rate;
- operating results and financial condition fluctuations on a quarterly and annual basis;
- history of losses;
- maintaining and managing growth;
- risks related to new technology;
- competition risks;
- risks related to intellectual property;
- customer base and market acceptance;
- software and product defects and design risks;
- availability of key supplies;
- dependence of key personnel;
- the effect of government regulation;
- risks related to physical facilities;
- legal risks;
- risks related to future acquisitions;
- reliance on third parties; and
- risks related to Forward-Looking Information.

Since actual results or outcomes could differ materially from those expressed in the Forward-Looking Information provided by or on behalf of the Company, investors and others should not place undue reliance on any such Forward- Looking Information.

DIRTT cautions that the foregoing lists of factors are not exhaustive. Further, Forward-Looking Information is made as of the date hereof, and the Company undertakes no obligation to update Forward-Looking Information to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable Canadian securities laws. New factors emerge from time to time, and it is not possible for DIRTT's management to predict all of these factors and to assess in advance the impact of each such factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in Forward-Looking Information. No assurance can be given that these expectations will prove to be correct and such Forward-Looking Information contained in this news release should not be unduly relied upon. In addition, this news release may contain Forward-Looking Information attributed to third party industry sources.

For a detailed description of the risks and uncertainties facing the Company and its business and affairs, readers should refer to the Company's annual financial statements, management's discussion and analysis and annual information form for the year ended December 31, 2018, all of which are available at http://www.sedar.com.

For further information, please contact:

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