



# **INVENTRONICS LIMITED**

## **2017 THIRD QUARTER FINANCIAL REPORT**

### **MANAGEMENT'S DISCUSSION & ANALYSIS**

**For the periods ended September 30, 2017**

## 2017 Third Quarter Financial Report – September 30, 2017 Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") is dated November 24, 2017 and was prepared based on information available to Inventronics Limited (referred to herein as "Inventronics" or the "Corporation") as of this date to help readers interpret Inventronics' financial results for the three and nine month periods ended September 30, 2017. This financial report, including the Statement of Financial Position, Statement of Comprehensive Income, Statement of Cash Flows, Statement of Changes in Equity, and Notes to the Financial Statements (collectively referred to as the "financial statements") and this MD&A, should be read in conjunction with the Corporation's audited annual financial statements and accompanying MD&A for the year ended December 31, 2016, which are available on the SEDAR website at [www.sedar.com](http://www.sedar.com) under the Inventronics profile. All dollar amounts within this report are expressed in Canadian dollars ("CAD") unless otherwise stated.

### 1. Corporation Overview

Originally founded in 1970 in Brandon, Manitoba, Canada, Inventronics designs and manufactures protective enclosures for use in utility-type infrastructures. The Corporation's products are found in telecommunication networks, cable television networks, electric power distribution networks, traffic control systems and oil and gas installations where they are utilized in both outdoor and indoor applications to house and protect passive and/or active electrical and electronic components. Although the Corporation's products have been primarily placed in service throughout North America, it is not uncommon to find Inventronics enclosures in other international infrastructures as well. A significant portion of Inventronics' sales are for products that are custom designed and manufactured to suit the needs of each customer for particular applications. This can range from the modification of an existing cabinet configuration to the conceptualization and manufacture of a brand new enclosure. The Corporation also markets a line of Inventronics-branded standard enclosures which are sold directly to utilities, original equipment manufacturers or through distributors. In some circumstances, the customer's components are incorporated into the enclosures which are delivered directly to the end user, providing a complete outsourcing service.

The industries in which the Corporation's products are utilized are going through considerable transformations to adapt to changing competitive and regulatory environments, new technology and new consumer demands. In the telecommunications sector, traditional telephone companies have made extensive inroads into non-traditional markets such as television transmission as well as improving and expanding internet services with high-speed and wireless offerings. Telecommunication networks are being modified to handle the substantial data volume requirements of these new services. Traditional cable companies, on the other hand, are actively converting their networks to enable high-speed internet capabilities while extending the reach of their networks into new regions. Within the electric power industry, aging power grids throughout North America have struggled with security risks and escalating demands for electricity from factors such as the construction of new neighbourhoods, larger houses requiring additional lighting and temperature control and the increased use of electronics. This increasing demand, and the possibility of a substantial additional need with a widespread adoption of electric motor vehicles, has resulted in the need to upgrade many existing power generation and distribution networks.

Inventronics operates from its ISO 9001:2015 certified facility located in Brandon, Manitoba where product design, manufacturing, corporate administration and sales functions are performed. The Corporation's production employees are organized under the United Steelworkers Union ("USW"). The Corporation is incorporated in the Province of Alberta, Canada, has no subsidiaries and its shares are publicly traded on the TSX Venture Exchange under the symbol IVX.

### 2. Selected Annual Financial Information

<b>Selected Annual Financial Information</b>			
<i>(in thousands of dollars, except per share amounts)</i>			
<b>For the years ended December 31</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Revenue	3,830	4,187	4,872
EBITDA <sup>1</sup>	213	82	123
Net loss	(283)	(414)	(380)
Total assets	3,268	3,513	3,814
Long-term debt, excluding current portion	2,234	2,270	2,304
Basic and diluted loss per share	(6.4)¢	(9.4)¢	(8.6)¢

*Note 1. See "Non-IFRS Measures" below.*

### 3. Summary of Financial Results

A modest strengthening in overall product demand that began in the latter part of 2016 had continued throughout much of the first nine months of 2017. Characteristic for both the three and nine month periods ended September 30, 2017, the Corporation experienced modest improvements, compared to the same periods of 2016, in product demand across a number of customers and across multiple industries and geographical locations.

During the third quarter of 2017, the Corporation completed a review of its estimated useful lives and residual values for its property, plant and equipment in light of current and forecast production volumes. The result of the review was to extend the useful lives and/or increase the residual values on several of the Corporation's capital assets, thereby, reducing depreciation expense to a level more appropriate to the Corporation's expected production volumes (see "Change in Accounting Estimate - Depreciation and Amortization" below). The Corporation accounted for the resulting adjustment to depreciation and amortization prospectively, effective as of the beginning of the current fiscal year, and did not issue restated interim reports for previously released periods that were affected. These periods consisted of the first and second quarters of 2017 and the below table identifies the restated amounts, where applicable, along with the previously reported amounts.

#### Selected Quarterly Financial Information

(in thousands of dollars, except percentage and per share amounts)

	2017			2016			2015	
	Q3	Q2 <sup>2</sup>	Q1 <sup>2</sup>	Q4	Q3	Q2	Q1	Q4
Revenue	1,224	1,113	1,008	1,009	981	1,080	760	822
Cost of sales as a percentage of Revenue <sup>2</sup>	80%	79%	78%	89%	88%	84%	102%	109%
EBITDA <sup>1</sup>	127	94	88	76	90	130	(83)	(108)
Net income (loss) <sup>2</sup>	68	32	26	(46)	(34)	5	(208)	(230)
Basic and diluted earnings (loss) per share <sup>2</sup>	1.5¢	0.7¢	0.6¢	(1.1)¢	(0.8)¢	0.1¢	(4.7)¢	(5.2)¢

Note 1. See "Non-IFRS Measures" below.

Note 2. Applicable to 2017 Q2 and 2017 Q1 only, see "Change in Accounting Estimate - Depreciation and Amortization" below. For 2017 Q2 and 2017 Q1: Cost of sales as a percentage of Revenue originally reported as 85% and 84%, respectively; Net income (loss) originally reported as a net loss of \$27,000 and a net loss of \$34,000, respectively; Basic and diluted earnings (loss) per share originally reported as a loss of 0.6 cents and a loss of 0.8 cents, respectively.

### 4. Results of Operations

#### Revenue

Revenue for the third quarter of 2017 of \$1.22 million was \$243,000, or 25%, greater than the \$981,000 reported for the comparative quarter of 2016. Revenue for the nine months ended September 30, 2017 of \$3.35 million was \$524,000, or 19%, greater than the \$2.82 million reported for the comparative period of 2016. For both periods, the improvement was attributed to general and modest increases, compared to fiscal 2016, in demand from many of the Corporation's customers across multiple sectors.

#### Cost of Sales

Cost of sales as a percentage of revenue for the three and nine month periods ended September 30, 2017 of 80% and 79%, respectively, was an improvement compared with the 88% and 91% reported for the comparative periods of 2016, respectively, due to a reduction in depreciation expense (see below).

Depreciation and amortization expense included in cost of sales for the three and nine month periods ended September 30, 2017 of \$20,000 and \$61,000, respectively, was lower than the \$81,000 and \$244,000 reported for the comparative periods of 2016, respectively, as a result of the impact to depreciation expense for a change in estimated useful life and/or residual value on some of the Corporation's capital assets that was accounted for prospectively as of the beginning of 2017 (see "Change in Accounting Estimate - Depreciation and Amortization" below).

#### Selling and Administration Expense

Selling and administration expense as a percentage of revenue for the three and nine month periods ended September 30, 2017 of 11% and 13%, respectively, was consistent with the 11% and 13% reported for the comparative periods of 2016, respectively.

#### Interest

Interest expense for the three and nine month periods ended September 30, 2017 of \$39,000 and \$122,000, respectively, was modestly lower than the \$43,000 and \$130,000 reported for the comparative periods of 2016, respectively, reflecting lower debt principal balances and interest rates in 2017 compared to the prior year.

## Net Income or Loss

For the third quarter of 2017, the Corporation reported net income of \$68,000, or 1.5 cents per share, compared to a net loss of \$34,000, or 0.8 cents per share, for the comparative quarter of 2016 where the improvement compared to 2016 was due to higher revenue and lower depreciation and amortization charges in 2017.

For the nine months ended September 30, 2017, the Corporation reported net income of \$126,000, or 2.9 cents per share, compared to a net loss of \$237,000, or 5.4 cents per share, for the comparative period of 2016 where the improvement compared to 2016 was attributed to higher revenue and lower depreciation and amortization charges in 2017.

## 5. Income Taxes

At December 31, 2016, the Corporation had Canadian non-capital losses of \$526,000 (2015 - \$526,000). There were no Canadian non-capital losses that expired in 2016 (2015 - \$0) and the remaining Canadian non-capital losses are scheduled to expire as follows:

*(In thousands of dollars)*

2026	268
2028	91
2034	50
2035	117
<u>Total</u>	<u>526</u>

At December 31, 2016, the Corporation had non-expiring Scientific Research & Experimental Development ("SR&ED") deductible cost pools of \$119,000 (2015 - \$119,000) and federal and provincial SR&ED investment tax credits of \$96,000 (2015 - \$96,000) due to expire in 2025.

## 6. Liquidity and Capital Resources

### Cash Flow from Operations

The Corporation considers a more useful measure of cash flow from operations to be cash flow from operating activities before changes in non-cash working capital balances. For the three months ended September 30, 2017, the Corporation's operations generated cash flow of \$122,000 compared to cash flow of \$85,000 for the comparative quarter of the prior year. For the nine months ended September 30, 2017, the Corporation's operations generated cash flow of \$294,000 compared to cash flow of \$122,000 for the comparative period of 2016.

### Cash Flow from Operations

*(in thousands of dollars)*

<i>For the periods ended September 30</i>	<b>Three months</b>		<b>Nine months</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Net income (loss)	68	(34)	126	(237)
Add: Interest on long-term debt <sup>1</sup>	34	38	106	114
Add: Depreciation	20	81	61	244
Add: Other items not involving cash	-	-	1	1
<u>Cash flow from Operations</u>	<u>122</u>	<u>85</u>	<u>294</u>	<u>122</u>

*Note 1. Interest on long-term debt considered a component of financing and therefore added back to net income (loss)*

*to determine cash flow from operations.*

### Working Capital Position

As at September 30, 2017, the Corporation reported a working capital balance of \$426,000, which represented a \$69,000 and \$123,000 improvement over the third quarter and first nine months of 2017, respectively. The change in working capital over the third quarter of 2017 was the result of: cash flow from operations of \$122,000; less: payments for long-term debt interest and principal of \$44,000; and capital expenditures of \$9,000. The change in working capital over the first nine months of 2017 was the result of: cash flow from operations of \$294,000; less: payments for long-term debt interest and principal of \$134,000; capital expenditures of \$31,000; and an increase in the current portion of long-term debt of \$5,000.

## Working Capital Position

(in thousands of dollars, except ratio calculation)

At the end of	2017			2016				2015
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Current assets	1,193	1,334	1,286	1,034	1,065	1,096	1,086	975
Current liabilities	767	977	959	731	782	844	904	658
Working capital	426	357	327	303	283	252	182	317
Working capital ratio	1.56 :1	1.37 :1	1.34 :1	1.41 :1	1.36 :1	1.30 :1	1.20 :1	1.48 :1

At September 30, 2017, the Corporation's working capital ratio was 1.56:1. It is management's belief that the Corporation's working capital position at September 30, 2017 is sufficient to support the current operating requirements of the business.

## Working Capital Liquidity

Working capital liquidity for operating purposes has generally been provided through positive cash flow from operations and the Corporation's line of credit arrangement. The Corporation's line-of-credit limit is \$850,000 and is margined on trade accounts receivable and inventories (see "Borrowing Arrangements and Covenants" below).

## 7. Share Capital

An unlimited number of common shares are authorized for issue. The following table summarizes the authorized, issued and outstanding common shares of the Corporation.

### Share Capital

(dollar amounts in thousands)

As at	September 30, 2017		December 31, 2016	
	Shares	Amount	Shares	Amount
Authorized, issued and outstanding common shares	4,405,145	\$ 2,276	4,405,145	\$ 2,276

There was no change to the Corporation's share capital during the nine and twelve month periods ended September 30, 2017 and December 31, 2016, respectively, and there was no change to the Corporation's share capital since September 30, 2017.

## Stock option plan

Inventronics maintains a stock option plan providing the Corporation the ability to grant options to employees and directors to purchase one common share of the Corporation per option. At September 30, 2017, there were 400,000 options granted, outstanding and exercisable with an exercise price of \$0.10 (December 31, 2016 - 400,000). There was no activity with respect to the Corporation's stock option plan during the nine and twelve month periods ended September 30, 2017 and December 31, 2016, respectively, and there was no activity related to the Corporation's stock option plan since September 30, 2017.

## 8. Borrowing Arrangements and Covenants

### Operating credit

The Corporation maintains a demand operating credit facility with its banker utilized by way of a line-of-credit, margined on the Corporation's accounts receivable and inventory balances and secured by a general security agreement constituting a first ranking security interest on all personal property of the Corporation and *Section 427 of the Bank Act (Canada)* security over inventory. Effective August 25, 2016, the Corporation reduced its authorized limit to \$850,000 from \$1.25 million and received a reduction in interest rate to prime plus 2.50% from prime plus 2.75%. There are two financial covenants pertaining to this demand operating credit facility that are tested annually at December 31: (i) working capital ratio; and (ii) debt to tangible net worth ("DTNW") ratio. The Corporation is in compliance with all covenants and obligations pertaining to this arrangement.

### Long-term debt

The Corporation has a long-term lending agreement in the form of a fixed rate mortgage maturing in 2042; bearing interest of 6.0%; repayable monthly in blended principal and interest installments of \$14,571; secured by a mortgage on the Corporation's production facility and land in Brandon, Manitoba, a general security agreement providing a security interest in all of the Corporation's present and after acquired personal property but accepting a subordinate position to all existing registered charges. Effective April 10, 2017, after a five-year period from the initial loan agreement date, the loan was subject to a market-based interest rate adjustment in accordance with the loan agreement. The Corporation selected a 2-year fixed interest rate term with an interest rate and installment amount as described above. Prior to April 10, 2017, the interest rate was 6.6% with a monthly blended principal and interest installment of \$15,409. Although containing general performance conditions, the loan agreement does

not contain any financial covenants that must be periodically tested. The Corporation is in compliance with all covenants and obligations pertaining to this arrangement.

### **9. Foreign Currency Exposure**

For the three and nine month periods ended September 30, 2017, the Corporation did not have a significant direct exposure to foreign currency risk as a majority of its sales were delivered to the Canadian marketplace and denominated in Canadian dollars ("CAD"), a substantial majority of the Corporation's purchases were denominated in CAD and the Corporation maintained minimal United States dollar ("USD") cash balances.

### **10. Collective Bargaining Agreement**

The Corporation's production labour force is organized under a collective bargaining agreement ("CBA") with the USW. The most recent CBA expired on May 31, 2017 and the Corporation and its unionized employees have continued to operate under that agreement. The Company has been notified by the USW of its intent to negotiate but, as yet, the process has not commenced.

### **11. Related Party Transactions**

The Corporation did not have any transactions with related parties during 2017 other than that which is disclosed in note 14 of the Corporation's interim financial statements for the quarter ended September 30, 2017.

### **12. Governance**

The Corporation's Board is comprised of three members of the Corporation's senior management team and two independent members. The Corporation's President and the two independent members sit on the Corporation's Audit Committee. Prior to June 23, 2017, the Corporation's Board was comprised of the four members of the Corporation's senior management team. On June 23, 2017, one member of the Corporation's senior management team resigned their position on the Board to make available a second Board position and two independent directors were appointed to fill these positions. On November 24, 2017, with the Corporation's Annual General Meeting of Shareholders, the number of Board positions was increased to six and the existing five Board members were re-elected, along with the member of the Corporation's senior management team who previously resigned their Board position on June 23, 2017.

### **13. Non-IFRS Measures**

#### **EBITDA**

Earnings before interest, tax, depreciation and amortization ("EBITDA") is not a recognized measure under International Financial Reporting Standards ("IFRS"). However, management believes that EBITDA is a useful supplementary measure to net earnings, as it provides investors with an indication of cash earnings prior to debt service, capital expenditure, income tax and non-cash items. Readers should be cautioned, however, that EBITDA should not be construed as an alternative to net earnings determined in accordance with IFRS as an indicator of the Corporation's performance or to cash flows from operating, investing and financing activities as a measure of liquidity or cash flows. The Corporation's method of calculating EBITDA may differ from the methods by which other companies calculate EBITDA and, accordingly, the EBITDA used herein may not be comparable to measures used by other companies.

A reconciliation of EBITDA to net income is:

#### **Reconciliation of EBITDA to Net Income (Loss)**

*(in thousands of dollars)*

<b>For the periods ended September 30</b>	<b>Three months</b>		<b>Nine months</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
EBITDA	127	90	309	137
Less: Depreciation and amortization	20	81	61	244
Less: Interest expense	39	43	122	130
Net income (loss)	68	(34)	126	(237)

## **14. Change in Accounting Estimate**

### **Depreciation and Amortization**

*IFRS IAS 16 Property, Plant and Equipment* recommends that the useful life and residual value of assets be reviewed if expectations differ from previous estimates. During the third quarter of 2017, the Corporation's management completed a review and revised its assumptions as to the level of business the Corporation is likely to experience over the foreseeable future and the manner in which it is likely to utilize its property, plant and equipment based on these assumptions. As the Corporation has lowered its revenue growth expectations to be flat-to-modest, the Corporation's management is assuming that much of the Corporation's equipment will be useful to the Corporation over a greater period than previously estimated. Further, it is management's view that prior residual values were, in hindsight, conservative as they were established during a time of economic recession and depressed secondary equipment markets. In accordance with *IAS 16* and *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*, the Corporation accounted for the results of its review as a change in accounting estimate to be applied prospectively. The Corporation applied this change as of the beginning of the current fiscal year and did not issue restated interim reports for 2017 Q1 and 2017 Q2. For 2017 Q1, the amended depreciation and amortization expense was \$20,200 which was originally \$80,100. For 2017 Q2, the amended depreciation and amortization expense was \$20,200 which was originally \$80,000. The impact for the three and nine month periods ended September 30, 2017 was to reduce depreciation and amortization expense from \$79,500 and \$239,600, respectively, to \$20,300 and \$60,700, respectively.

## **15. Outlook**

In addition to other sections of this MD&A, this section contains forward-looking information and actual outcomes may differ materially from those expressed or implied therein. For more information, see the below section titled "*Forward-looking Information*" in this MD&A.

The Corporation's revenues often show a close correlation to Canadian economic conditions. Although there are indications that the general economic outlook in Canada has been improving, there continues to be many economic and political factors that are lending considerable uncertainty to the Canadian economy and, consequentially, the Corporation's outlook. With respect to the fourth quarter of 2017, based on current customer order patterns, the Corporation is forecasting revenues consistent with the comparative quarter of 2016.

## **16. Forward-looking Information**

Certain statements contained in this report, including this MD&A, contain forward-looking information that represents the Corporation's internal projections, expectations, estimates or beliefs concerning, among other things: the Corporation's expectations, perceptions and beliefs with respect to the industries with which the Corporation is exposed, the strategic direction of those industries and the reasons thereof; the Corporation's expectations, perceptions and beliefs with respect to its future revenue levels and production volumes; the Corporation's expectations, perceptions and beliefs with respect to the manner in which the Corporation will utilize its property, plant and equipment and the ultimate residual value of that property, plant and equipment; the Corporation's expectations, perceptions and beliefs with respect to its working capital position and its sufficiency to support the Corporation's current operations; the Corporation's expectations, perceptions and beliefs with respect to the economy in general, and the related impact on the Corporation's customers and/or demand for the Corporation's products; and the Corporation's expectations, perceptions and beliefs with respect to its forecast financial results for the fourth quarter of 2017. All statements other than the statements of historical fact may be forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates", and similar expressions. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which could cause actual results to differ materially from those anticipated in these forward-looking statements. These risks and uncertainties include, but are not limited to: foreign currency fluctuations; variability of quarterly operating results; general economic conditions; actions by government authorities; competitor activity; indebtedness of the Corporation; customer concentration risks; availability of future financing; changes in the price of raw materials; interest rates; and changes in the communications, power and cable industries. With respect to the forward-looking statements contained in this MD&A we have made certain assumptions with respect to, among other things, economic conditions and their impact on the Corporation's revenues and the spending patterns of the Corporation's customers. Although management of the Corporation believes such assumptions are reasonable, undue reliance should not be placed on forward-looking information as the Corporation can give no assurance that such assumptions will prove to be correct. The forward-looking information has been included herein to provide shareholders with a more complete outlook on the Corporation's future business and operations and this information may not be appropriate for other purposes. The Corporation does not undertake to update the forward-looking information contained herein except as required by applicable laws.

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